November 8, 2005

Dear SEC:

I am writing with regard to the NYSE's September 21, 2005 comment letter on the above-referenced rule submission. As that letter discusses amendment number 6 to that rule submission, I am also commenting on that matter, even though it has not yet been published by the Commission for formal public comment.

Let me state preliminarily that the comment letter is an embarrassment to the NYSE, but regrettably all too typical of the material emanating therefrom these days. Far from responding to all the significant, substantive issues raised by commentators, the NYSE has chosen to respond only to a handful, ignoring those that get to the heart and soul of the matter. Presumably, by proceeding in this fashion, the NYSE staff is acknowledging that many aspects of the proposal are absolutely indefensible.

And the absolute piece de resistance is the NYSE staff's inability to distinguish between the specialists' affirmative and negative obligations.

The NYSE's "responses", if one can dignify them with such a word, consist largely of regurgitations of points previously made (and found lacking by commentators). To the limited extent that it does deal with issues raised, the NYSE simply presents conclusory assertions that its proposal is in the public interest, rather than join issue with the substance of the objections being made. The NYSE staff apparently are incapable of demonstrating, by means of a legal reasoning process, exactly "why" any of this in fact meets the needs of public investors.

Amendment number 6, the latest in an increasingly desperate series of attempts by the NYSE staff to provide unconscionable advantages to floor brokers at the expense of the public limit order book, is cosmetic, insulting fluff. The NYSE comment letter and amendment number 6 do not deal at all with (1) the huge informational advantage floor brokers have in placing orders; (2) the superseding of the price/time priority of public limit orders on the public limit order book; and (3) the fact that floor brokers get as many "bites of the apple" as there are floor broker orders, whereas public limit orders on the public limit order book collectively get only one "bite of the apple", regardless of many such orders are on the public limit order book, or when they were entered. (These points were the subject of prior, major objections). Not only has it failed to defend any of this, but the NYSE is now proposing a new absurdity, the phenomenon of a floor broker being able to "have his/her cake and eat it too" by receiving executions as though he/she had displayed liquidity, when in fact he/she had not. In practical effect, in the event, this is as meaningless as it is laughable.

The comment letter and amendment number 6 are similarly pitiful when dealing with the specialist. The proposal that the specialist display 1000 shares (rather than 100 as previously) before being allowed to provide "algorithmic price improvement" simply moves the proposal from the egregious and insulting to the ridiculous and insulting. The critical point, ultimately, is not the size of the specialist's displayed order, but whether or not the specialist's displayed order has priority (the true test of genuine price improvement). In reality, the specialist will be providing "algorithmic price improvement" only when the specialist's displayed order does not have priority (rendering the actual size displayed immaterial), in which case the specialist gets to deny executions to orders on the public limit order book that do have priority, while affording the specialist a likely (specialists will not be fools in programming the algorithm) profitable proprietary trading opportunity.

And, of course, the NYSE has not responded to objections about specialists, in essence, being given "insider trading" opportunites, as well as trading opportunities that stand the negative obligation on its ear.

The NYSE letter amply demonstrates how weak and untenable the NYSE's positions really are.

Background

In a section of its September 21, 2005 comment letter headed Background, the NYSE regurgitates its prior positions about the purported benefits of its so-called "hybrid market." Most of the discussion is pro forma and self-serving, but what is truly offensive is the NYSE's insistence that it is not "eliminating time-tested procedures" and that customers "can still utilize the traditional benefits of the auction process." The NYSE marketing machine continues to disseminate the palpable falsehood that the proposed "hybrid market" is simply overlaying a wondrous new means of electronic trading on top of its traditional physical auction market, with the benefits of the physical auction continuing as ever thus.

In my July 20, 2005 comment letter, I demonstrated why the NYSE proposal is more appropriately characterised as a "mutant" rather than a "hybrid." In SR-NYSE-2005-57, the NYSE admitted it was removing elected stop and CAP orders from the physical auction, denying them the opportunity for price improvement. In SR-NYSE-2004-05, the NYSE is proposing a "sweep" methodology that forces trade initiators to trade at the worst possible prices, whereas in today's physical auction a broker can trade at intervening prices to obtain the best possible overall price for an order. The NYSE refuses to discuss its de facto rescission of Rules 76/91, the NYSE's order exposure/price improvement rules that are the heart and soul of its physical auction. These rules effectively provide hundreds of millions of dollars in price improvement each year to public investors, but the NYSE studiously avoids any mention of them. (At the barest possible minimum, the NYSE needs to propose and justify rule amendments here).

The NYSE is proposing to adopt bizarrely misnamed "auction market orders" and "auction limit orders" which have at most only a tangential relationship to the physical auction, and which can be executed at worse prices as later arriving orders exhaust contra side liquidity, a result unknown in today's physical auction. Broker-dealers with best execution responsibilities, who could rely on Rules 76/91 for price improvement, will have to look elsewhere, as they cannot run the risk of "price disimprovement." I have raised these points in prior correspondence, and the NYSE's continued silence manifests its inability to deal with them.

The physical auction is further rendered irrelevant by the NYSE's Santa Claus-like gifting of exclusive proprietary trading opportunites to the specialist, notwithstanding the clear strictures of the negative obligation. And the "sweep" methodology largely obviates the affirmative obligation, as the NYSE has simply ignored the question of how the specialist is supposed to act to maintain a fair and orderly market (as he/she does in the physical auction) by minimising price dislocation when a large-size order is entered on only one side of the market.

In sum, for all intents and purposes, the "physical auction" component of the "hybrid market" is a highly modified/truncated rump of the physical auction that exists today, and most of the order exposure/price improvement benefits of the physical auction to public investors will largely be eliminated.

It is the NYSE's prerogative to propose these changes, but it is an absolute fraud on the public for the NYSE to maintain at the same time that the public "can choose to utilize the traditional benefits of the auction process." This is not simply a matter of arguing over "marketing" terms; the public is clearly being deceived here. The SEC staff must demand that the NYSE fairly characterise its proposal.

The "electronic" component of the "hybrid market" can only be understood as an unsavoury, self-serving accommodation to its floor trading constituency. I have previously described how the NYSE's proposed structure of three competing limit order books (the fully transparent public limit order book, and the largely hidden (except for relatively token and discretionary disclsure at the current bid/offer) "broker agency interest files" and "specialist layered interest file") operates to the disadvantage of the public limit order book, and posits a functionality unknown (with good reason) in any major securities market anywhere.

The NYSE proposal is the sort of "think inside the box, win the battle but lose the war" conceptual approach that business schools study as the classic wrong way to innovate. There are two critical "design flaws" here. First, the NYSE is corrupting its single greatest resource in an era of highly competitive markets, the transparency of its market. By compromising the price/time execution priority of orders on the public limit order book, the NYSE is clearly disincenting the placement of such orders in the first instance. This disincentive is further exacerbated by the NYSE's proposed specialist "algorithmic price improvement", whose practical effect is to deny executions to orders on the public limit order book, as the specialist would be permitted to electronically intercept orders that would otherwise trade with the public limit order book.

But a viable, fully transparent public limit order book is a critical component of the price discovery process, particularly in a primary market such as the NYSE. The proper business strategy for the NYSE (as for any viable market serving the public interest) is to promote the primacy of the public limit order book, thereby incenting the placement of orders thereon, thereby attracting and retaining order flow, thereby promoting the most efficient pricing of orders, thereby enhancing the overall price discovery process, etc.

The NYSE's actions here are bizarrely counter-intuitive, because the hidden (non-liquidity attracting) orders eligible for automatic execution make the market opaque rather than transparent as to those orders, and by disincenting the placement of public limit orders, they virtually ensure that the NYSE will be displaying far less liquidity overall. This, in turn, disincents the transmission of order flow to the NYSE in the first place, thereby undercutting the viability of the NYSE's historic strength, its price discovery process.

The NYSE proposal in this regard can only be understood as a sell-out to its near-sighted trading floor constituency, which should not be permitted to hold hostage the public interest. While the SEC needs to promote competition among markets, the Commission needs to consider protecting the public interest by, in essence, "protecting the NYSE from itself." Losing the viability of a primary market's price discovery mechanism, when only fragmented, tertiary order execution alternatives are available, can only result in inferior pricing and economic harm to public investors.

The SEC's mandate obviously is not to ensure the survivability of the NYSE or any other market. But the Commission cannot simply allow a primary market's price discovery mechanism to implode as privileged intermediaries seek to provide themselves with what are sure to be, at most, only short-term gains. While not necessarily ensuring any particular competitive outcome, the Commission must, consistent with its overall approach to the National Market System, insist upon the primacy of the NYSE's public limit order book as the most appropriate means of promoting market transparency and efficient price discovery in the public interest.

The second "design flaw" in the NYSE's proposal is its attempt to preserve by arbitrary regulation a role for its trading floor constituency, rather than (as good capitalists should!!) allow market forces to determine what role, if any, the NYSE's floor intermediaries should play. The NYSE's efforts in this regard are the classic, highly defensive, and ultimately self-defeating strategy of a business that is afraid of real competition, and seeks to preserve a niche by artificial restraints on competitive forces. Clearly, in a physical auction requiring manual representation and execution of orders, a floor intermediary is essential to effectuate certain startegies. But in the electronic market contemplated by the NYSE, a floor intermediary is largely superfluous because orders can be entered (from virtually anywhere) and executed electronically. To the extent any institution finds any value in the rump physical auction the NYSE is proposing to retain, it is free to arrange for the services of a floor broker. But to the extent an institution wishes to enter electronic orders in the same manner as the NYSE is proposing for floor brokers, it should be free to do so. An institution understands its own trading strategy far better than any floor broker it might retain, and is obviously in the best position to know how to enter and manage its orders (notwithstanding the NYSE's penchant for self-serving rhetoric about "floor broker expertise").

The NYSE is propounding the bogus notion of floor broker "electronic representation" of orders, as though the clerical order entry task associated therewith had anything to do with the actual execution of the order, which is the only task the institution ultimately cares about. The floor broker does not "electronically represent" an order he/she has transmitted to the (largely) hidden go along limit order book. The order lies inert on that limit order book, awaiting electronic, intermediary-less execution, in the same manner as an institution's Superdot limit order lies inert on the public limit order book. To the extent that an order needs to be "electronically managed", an institution is perfectly capable of doing that from wherever, if it so chooses.

The NYSE, however, to protect its floor brokers, is proposing an artificial restraint on institutional order entry. While institutions are free to enter Direct (automatic execution) orders to initiate a trade, and conventional Superdot limit orders, they are not free to enter electronic go along or CAP orders. Instead, they must retain the costly services of a floor broker to perform a task they are fully capable of performing themselves, namely the entry of an electronic order to lie inert on the go along limit order book until executed.

This "forced intermediation" is expensive, unnecessary, anti-competitive, and clearly intended to maintain an artificially protected niche for floor brokers. The ultimate survivability or extinction of the floor broker tribe should depend on whether or not they provide genuine "value added" to their institutional customers, not on their being monopolistic, rule-protected electronic order entry clerks. Fundamental fairness dictates that institutions must be given order entry flexibility with respect to all order types, including CAP orders. The "value added" floor brokers will continue to thrive; the others will have to adapt to the same "real world" competitive pressures faced by intermediaries everywhere else.

I (and others) have made this point previously. The NYSE comment letter, however, completely ignores this issue, which is a major expense item for the very constituency the NYSE is purporting to serve. This issue has angered institutions familiar with it; the NYSE comes across as particularly arrogant here in not even acknowledging institutional concerns, much less attempting to defend its position. (But then again, it is impossible to defend the indefensible).

My raising the issue of the NYSE's "design flaws" is not to suggest a quibble over competing visions of what would constitute a "hybrid market." My point is simply that the NYSE has presented a "market structure" that cannot be treated as anything other than an assertion of naked self-interest, cloaked in a term ("hybrid market") that the NYSE has adopted for "marketing" purposes but does not intellectually comprehend (more on this in my July 20, 2005 comment letter).

The practical effect of the two "design flaws" I have noted is to severely compromise the historic strengths of the NYSE (transparency, order exposure, price improvement, primary market price discovery mechanism), and replace a market structure that has served the public well (albeit in need of reasonable, put-the-public-first modernisation) with a structure that distorts the price discovery process, imposes unreasonable and unnecessary expenses on major customers, and provides unconscionable benefits to privileged intermediaries to the detriment of public investors.

The SEC staff must stand absolutely firm here in upholding the public interest.

Floor Broker Hidden Orders and the Go Along Limit Order Book

In my March 10, 2005 and July 20, 2005 comment letters, I have described how the NYSE's meaningless gibberish term "broker agency interest file" actually refers to a floor broker's entry of a go along limit order on a (largely) hidden go along limit order book that gets to compete directly with the public limit order book. In my July 20, 2005 comment letter, I laid out an "ABC" execution schematic that represents the fairest way to execute the orders of the investing public, go along traders, and the specialist. I ask that the discussion of floor broker go along trading contained in my earlier comment letters be incorporated by reference herein.

The NYSE has singularly failed to respond to any of the substantive criticisms regarding the significant harm in its proposal to the public limit order book. It must be emphasised that, according to the NYSE's own figures, about 98% of all orders sent to the NYSE are routed through Superdot. Floor broker go along orders represent only about 2% of all orders (a larger amount of volume). The NYSE's purported "benefits" accrue only to go along traders, and the NYSE seems incapable of joining issue and discussing the negative consequences to the public limit order book. It is obviously another instance of the NYSE's being unable to defend the indefensible, so it just ignores it, even though it is the heart and soul of the matter. The NYSE's comment letter is simply intellectually dishonest in this regard.

The root of the problem is the NYSE's antiquated "parity" rule, a relic of a bygone era which the SEC staff has historically disdained as fundamentally unfair to public limit orders on the public limit order book with clearly established price/time priority. As the NYSE is proposing an entirely new context in which parity principles would operate, the SEC should act decisively here in rejecting the NYSE's approach, and insisting on the primacy of the fully transparent public limit order book.

1. Displayed Go Along Limit Orders at the NYSE Best Bid and Offer

Through what seems like an endless series of amendments to SR-NYSE-2004-05, the NYSE has been forced, with great reluctance and in the face of fierce public criticism, to provide some type of disclosure of go along orders. The NYSE's proposed 1000-share (only at the best bid/offer) minimum display requirement is better than nothing, but just barely. And the NYSE's belated, pompous assertion that displayed interest should trade ahead of non-displayed interest is completely undermined by the NYSE's adamant refusal to extend the principle to away from the market executions.

The disclosure of only 1000 shares is, of course, completely counter to what should be the NYSE's objective of promoting maximum transparency to enhance the overall price discovery mechanism. But leaving that point aside, there are two serious issues here.

(i) Floor brokers can enter go along limit orders in reaction to their knowledge of public orders on the public limit order book, and thereby supersede the clearly established price/time priority of such public limit orders. A simple example will suffice. A broker sees that the bid is 1000 shares, consisting of two 500 share orders. The floor broker enters a go along order for 1000 shares, which is displayed. A seller enters the market to sell 1000 shares to the bid. The first order on the public limit order book buys 500 shares, and the go along limit order buys 500 shares. The second public limit order is completely shut out, even though it was entered, and fully displayed, earlier in time than the go along limit order, and was part of the "informational mix" that led the broker to enter the go along limit order. If the market moves away, the second public limit order may never be executed.

This is fundamentally unfair to public investors, and unknown in any major securities market anywhere.

(ii) Another major problem is what I will call the "bites of the apple" manner in which the "parity" rule operates on the NYSE. Each "bidder" gets its own "bite of the apple" (each "bidder" gets an equal split in an execution). The public limit order book is deemed to be only one "bidder", regardless of how many individual orders are on that book at the same price. However, every broker who enters a go along order is considerred a separate "bidder" entitled to a separate split of an execution.

Again, a simple example will suffice. Assume that the public limit order book is bidding 10,000 shares. This bid consists of 10 1000 share public limit orders. Nine floor brokers (not atypical in an active stock) each note the 10,000 share public limit order bid, and each enters a 1000 share displayed go along limit order. A seller enters the market to sell 10,000 shares to the bid. The first limit order on the public limit order book will buy 1000 shares, and each go along order will buy 1000 shares. The other nine public limit orders are completely shut out, even though they were entered prior in time to the go along orders.

If the superseding of the public limit order book's price time priority is outrageous, the "bites of the apple" favoritism to the go along limit order book is truly egregious. And the NYSE does not at all act in candor and good faith here because the examples in its submissions always show only one go along order competing with the public limit order book. The "bites of the apple" problem is so offensive and indefensible that the NYSE goes to great lengths to disguise it.

2. Sweep Executions and Hidden Go Along Orders

The NYSE acts as though hiding go along limit orders at away from the market prices were some inexorable law of nature, when in fact it is simply a choice made by a floor broker. Brokers choose not to display their orders, but the NYSE is determined to reward them as though they had in fact made such a display.

The superseding of price/time priority and "bites of the apple" problems exist in sweep transactions as in executions at the best bid/offer. But there is another, hugely significant problem that arise in sweep executions.

In a sweep execution, contra side liquidity will be attracted by the transparent interest on the public limit order book. This is obvious: traders will enter large orders to access and trade with displayed liquidity. The hidden go along limit orders will not trigger sweep executions because the contra side trader cannot see them. But even though the public limit order book attracts the contra side liquidity, the go along orders are "rewarded" for being hidden and get to step ahead of the liquidity-attracting public limit order book. This is not only absurd, but gives hidden go along limit orders a huge advantage. They know about the public limit orders, but the public limit orders do not know about them. The public limit orders have absolutely no way to adjust their limit prices in reaction to orders being entered on the go along limit order book to compete with their orders. This is so patently unfair that it is difficult to believe that a major market such as the NYSE could possibly be proposing this. (In prior correspondence, I have described the hidden go along limit orders as "electronic parasites" that leech off of the liquidity attracted by the public limit order book).

In amendment number 6, the NYSE has proposed a "solution" so intellectuallly vacuous that it cannot possibly have been presented in good faith. The NYSE would solve the problem of non-disclosure of hidden go along orders by a requirement that a broker designate what portion of the hidden order "would be displayed" if the price of that order should ever become the best bid/offer. This "would be displayed" portion of the hidden order would then be permitted to trade "on parity" with (compete directly with and deny executions to) the public limit order book. In plain English, the broker still does not actually disclose anything, but is rewarded as though he had, a classic case of having one's cake and eating it too.

Let me state the obvious: the go along order is either disclosed to the public or it isn't. "Woulda-coulda-shoulda" just doesn't cut it in the real world. The fictional construct of "would be displayed" is meaningless because ultimately no one knows about it except the floor broker (the "would be displayed" is not actually displayed prior to a sweep transaction). The "would be displayed" order has nothing to do with attracting liquidity, and solves none of the problems of fundamental unfairness to the public limit order book, since investors with orders on the public limit order book still have no information about hidden "would be disclosed" orders.

Floor brokers can designate any fictional amount as "would be displayed", but will likely designate the entire order, as it costs them nothing in practical terms to do so. Brokers will not enter the order in the first place unless they intend for it to trade, as the order is eligible for automatic execution at any time (which simply means that this proposal, in practical terms, is nothing different from what the NYSE has been proposing all along).

In the unlikely event that the away from the market price actually becomes the best bid/offer, the floor broker will simply "electronically adjust" the go along order at that time to display what the broker actually intends to display (as opposed to the fictional, away from the market construct). In all likelihood, the broker will "electronically adjust" the displayed amount to the minimum 1000 shares, regardless of what had been the "would be displayed" fictional amount.

The NYSE's proposal, properly understood, is absolutely ridiculous and not at all responsive to the serious criticisms that have been made.

Floor Broker Hidden Go Along Orders and Specialist Hidden Dealer Orders Are in No Way Comparable to "Reserve Interest" in Other Markets

A highly objectionable portion of the NYSE comment letter (pages 6-7) makes the disingenuous claim that floor broker hidden go along orders (and, by implication, the specialist's hidden dealer orders) are comparable to "reserve features" that exist in other markets. This is a palable falsehood.

The only commonality between "reserve features" in other markets and the NYSE's proposed "hybrid market" is that orders are hidden. But the actual operation of "reserve features" in other markets is in no way similar to what the NYSE is proposing.

Markets with "reserve features" are, for the most part, non-primary, non-price discovery markets whose lack of transparency does not materially impact the overall price discovery process. But the critical distinction between "reserve feature" markets and the NYSE's proposed "hybrid market" is that there is no such concept as "parity" in these markets. A trader cannot enter a "reserve feature" order in these markets that will supersede the price/time priority of a previously entered order.

It really is this simple: "reserve feature" orders are executed in price/time priority. Period.

The NYSE is deceiving the Commission and the public here by suggesting that the "hybrid market" order execution schematic mirrors in any way "reserve feature" executions in other markets.

Rule 108 and the Specialist's Negative Obligation

In my November 1, 2005 comment letter (submitted as a comment on both SR-NYSE-2004-05 and SR-NYSE-2005-74), I discussed in detail the NYSE's refusal to acknowledge the background, history, and purpose of Rule 108, particulalrly the historic distinction, rooted in the negative obligation, between establishing and liquidating a position.

Rule 108 is written the way it is for a reason: to put the public interest ahead of the dealer account. For decades, Rule 108 has been applied in tandem with the negative obligation, because specialist parity acquisitions are the clearest instance imaginable of dealer trading in direct competition with public orders where there is no "market necessity" for such trading. I develop this point in my November 1, 2005 letter, and ask that it be incorporated by reference herein.

In prior correspondence (see particularly my comments on SR-NYSE-2005-57, as well as my November 1, 2005 comment letter), I have noted that heavy NYSE staff turnover has resulted in the NYSE's having to assign its rule submission work to inexperienced staff who simply do not understand what they are doing. The NYSE's September 21, 2005 comment letter demonstrates such world-class ignorance and stupidity (see below) in its discussion of the negative obligation that I must urge the SEC staff to review this matter with senior NYSE management. The NYSE cannot continue to misrepresent the plain meaning of its own rules, as it has done repeatedly over the last several years, culminating in the embarrassment of the NYSE's having to withdraw a few days after submitting it SR-NYSE-2005-69, a particularly moronic and duplicitous piece of work that is summarised/analysed in my October 11, 2005 comment letter on SR-NYSE-2005-57.

The NYSE staff's penchant for moronic, misleading, intelligence-insulting drivel reaches its absolute nadir on page 13 of the September 21, 2005 comment letter. The NYSE quotes the language of its Rule 104.10(3), which provides the following:

"Transactions on the Exchange for [the specialist's] own account effected by a member acting as specialist must constitute a course of dealings reasonably calculated tocontribute to the maintenance of price continuity with reasonable depth, and to minimzing of the effects of temporary disparity between supply and demand, immediate or reasonably to be anticipated. Transactions not part of such a course of dealings...are not to be effected."

The NYSE represents that this language constitutes the negative obligation. In fact, the very language quoted by the NYSE staff is the classic formulation of the affirmative obligation, as it states, by its plain terms, the specialist's obligation to trade pro-actively to maintain reasonable trade-to-trade price continuity, reasonable depth, and minimisation of short-term disparities between supply and demand. There is simply too much copious documentation in SEC and NYSE material that this is the affirmattive obligation for their to be even the slightest doubt on this issue. And there cannot be the slightest doubt that the affirmative obligation does not apply to specialists' parity acquisition activity, as this is "same price, compete with the public" trading with no issues of price continuity, the public orders are providing the requisite depth, and the question of whether there is an imbalance of supply and demand can only be answered after the public orders hav e finished trading with the contra side liquidity, at which point, and only at that point, is the specialist permitted to trade for the dealer account (in a non-parity transaction).

The negative obligation, the fundamental cornerstone of specialist regulation, is clearly, directly, and powerfully stated in the very first sentence of Rule 104 (impossible to miss):

"No specialist shall effect on the Exchange [tranactions for the dealer account]...unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market...."

The SEC and the NYSE, again in copious documentation, have clearly represented that this is the standard formulation of the negative obligation. It is obvious why specialist parity acquisitions have historically been prohibited by the SEC and the NYSE: there is no "market necessity" for such interference with public order execution.

The difference between the affirmative and negative oblligations is hardly a matter of semantics. The SEC's and NYSE's entire framework for regulating specialist dealer activity is premised on the distinction between the two. The inability of the NYSE staff to comprehend the differences between the two, and their misrepresentation of the affirmative obligation as the negative obligation, speak volumes about the credibility of the current NYSE rule submission staff.

The NYSE is simply "playing dirty" by foisting this garbage upon the Commission and the public.

Specialist "Algorithmic" Trading

The NYSE's September 21, 2005 comment letter does not address in any serious way the significant criticisms commentators have made of the NYSE's proposal to grant the specialist the exclusive right to engage in "algorithmic" trading for the dealer account.

The NYSE is proposing to permit the specialist (and only the specialist) to engage in "algorithmic" (computer-generated, with no pre-trade "sunlight") trading in two contexts:

(i) the specialist's "algorithm" may electronically intercept a "marketable" (i.e., an order immediately executable against the published bid/offer) order as it enters NYSE systems (before it is displayed to the world) and trade with it for the dealer account, in between the quote, to provide "price improvement;"

(ii) the specialist's "algorithm" may effect a trade for the dealer acount against incoming limit orders at virtually the same instant that they are "displayed" to the public.

In addition, the specialist's "algorithm" would be permitted to read incoming orders and "layer the book" (enter dealer orders) to participate in sweep transactions.

My July 20, 2005 comment letter discussed specialist "algorithmic" trading in detail. I ask that it be incorporated by reference herein.

The basic objections to "price improvement" trading are immediate and obvious, and the NYSE has not responded to them. The NYSE would grant this privilege exclusively to the specialist. The specialist's "algorithm" alone has knowledge of the incoming order, which gives the specialist, in effect, a unique "insider" proprietary trading opportunity. The NYSE's approach stands the negative obligation on its head, transforming the specialist from the trader of last resort to the only one who can trade in the first place. This aspect of the NYSE proposal alone makes it a non-starter. (The NYSE's position that the specialist's CAP orders will also get "price improvement" is particularly pathetic in this regard, as it merely highlights the NYSE's specialist-centered, no other intermediary need apply approach).

In my July 20, 2005 comment letter, I described in detail how the NYSE's proposal is really a license for the specialist to print money, and the NYSE is entirely silent as to my analysis. Specialists will only trade when they are "represented" in the quote (the NYSE has been careful to avoid the word "priority"), meaning that they will "algorithmically" trade only when an incoming order would not be executed against their own published dealer bid or offer. Specialists will program the "algorithm" to operate in likely "flip" situations where the specialist can turn a fast, greatly risk-reduced profit.

The only "safeguard" provided by the NYSE is a requirement that the specialist be "represented" in the published quotation for a minimum of 1000 shares in very active stocks (it can be as little as 100 in less active stocks. Formerly, the NYSE had proposed a 100 share requirement for all stocks). While the NYSE's move from 100 to 1000 shares for very active stocks is less overtly intelligence -insulting than its prior proposal, the new "safeguard" is absolutely meaningless in practical effect. Adding 1000 non-priority shares to a public bid/ offer of 10,000/20,000/30,000 shares or more in very actively traded stocks is a ridiculous, cosmetic gesture. It is only for show (the specialist does not have priority, but has to yield to his/her own orders on the book, or orders in the crowd), but the "show" permits the specialist (with exclusive knowledge of the incoming order) to jump ahead of existing market interest and electronically intercept the incoming orders.

As I have previously commented, there is no net economic benefit to the public here. The incoming orders are "marketable", meaning that they have been entered presumably with the intention of trading against the published bid/offer. The specialist's electronic interception of these orders denies an execution to the very orders that attracted them in the first place. The value of any "economic benefit" to the intercepted orders is offset by the harm to the public orders represented in the bid/offer that are denied an execution, and which may never be executed if market prices then move away from their limits. This is a huge disincentive to the placement of orders on the public limit order book, and the NYSE has simply ignored this very significant concern. The ultimate and exclusive beneficiary here is simply the specialist, and it is difficult to view this aspect of the NYSE's proposal as little more than an unconscionable scam.

There is one way that the specialist could provide genuine price improvement. The NYSE could mandate that the specialist can provide "price improvement" only when the incoming orders would otherwise trade against the specialist's priority bid/offer (no public order displacement). This is exactly what dealer markets offering "algorithmic price improvement" do. The incoming order benefits, and there is no offsetting harm to public orders. But this is not at all what the NYSE has proposed, with its meaningless requirement that the specialist merely be "represented" in the bid/offer rather than have priority.

But even if the NYSE did propose a "priority price improvement" schematic, the NYSE would still have to deal with the insurmountable exclusivity problem.

The NYSE's proposal to grant the specialist the right to trade "algorithmically" with incoming limit orders as they are displayed is similarly a non-starter in its provision of exclusive, insider-trading like opportunites to specialists. The proposal in this regard is particularly insulting to the public's intelligence. The NYSE would permit the specialist's "algorithm" to read incoming orders as they enter NYSE systems and "pounce" on them subject to a "delay parameter" based on "the average transit time from the Common Message Switch to the book." The English translation of this mumbo-jumbo is simple: the "delay time" is typically a matter of nanoseconds, which the NYSE rather conveniently neglected to mention. (I have confirmed this with NYSE staff).

The "delay parameter" is obviously entirely meaningless. The instant the incoming order is displayed, and before any human brain can process this information and react to it, the specialist's "algorithm", deeply embedded in NYSE systems, has already traded with the order. The NYSE isn't even making a pretense of acting in good faith here.

Let's see now: the specialist's "algorithm" has the exclusive franchise to intercept marketable orders before anyone sees them, and to trade against incoming limit orders the absolute instant the rest of the world even becomes aware of them. This essentially gives the specialist the exclusive right to trade against every single system order (of whatever size the NYSE specifies) at or between the quote sent to the NYSE. Nice work if you can get it. And what's the negative obligation among friends?

This doesn't pass even the most lenient giggle test, especially when the NYSE is proposing a 15-second wait for anyone actually dumb enough to enter one of the bizarre "auction market orders" or auction limit orders."

The NYSE's proposal is similarly offensive in giving the specialist's "algorithm" the exclusive ability to read incoming "sweep" orders as they enter NYSE systems and "layer the book" with dealer orders to participate in executions against them. As I pointed out in my July 20, 2005 comment letter, this is clearly insider trading by any conceivable legal standard, as the specialist, with material, non-public information, can enter orders to deny executions to public limit orders. (The NYSE offered no rebuttal here, another instance of the NYSE's being unable to defend the indefensible).

The Need for Plain English

In both my March 10, 2005 and July 20, 2005 comment letters, I emphasised the need for the NYSE to dispense with its dense, self-invented jargon, and use plain, simple English. (I even provided the terms).

The NYSE has not attempted to defend its use of convoluted language rather than plain English, and I cannot help but note an absurdity in this reard. Apparently acknowledging the public's befuddlement at the linguistic black hole it created, the NYSE has now published a "glossary" of "hybrid market terms" on its website. I suppose it's all rather decent of the NYSE, having devised a strange new language, to publish a dictionary to help with the English translation (thereby admitting, of course, the incomprehensibility of its terminology).

I continue to urge the SEC staff to step in here and obviate the need for public investors to have to deal with the NYSE's dictionary.

What the NYSE's Customers Really Want

The NYSE likes to pretend that it listens to its constituents. And its order-generating and order flow supplying constituents have spoken loudly and clearly: first and foremost, eliminate the order entry limitations in the Direct system. This can be accomplished quickly, and it is to the NYSE's shame that it has delayed this (going on two years now) while it attempts to provide enhanced privileges for floor brokers and specialists.

Conclusion

Far from presenting a "hybrid market" incorporating the best of both physical auction and electronic trading, the NYSE has proposed a rump, largely meaningless physical auction and a means of electronic trading fatally compromised by an insistence on giving unique opportunites to privileged intermediaries to the detriment of the general public, and in a manner unknown in any major securities market anywhere.

The NYSE needs to stop holding hostage the elimination of Direct order entry limitations, and separately try to work through the ridiculous conceptual muddle it has created.

Mutant, indeed.

Sincerely yours,

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