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December 10, 2004

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Sent via e-mail to: rule-comments@sec.gov

Re: Amendment Nos. 2 and 3 to File No. SR-NYSE 2004-05

Gentlemen:

I am the managing partner of a hedge fund specializing in spread trading, mainly focusing on NYSE listed securities. I have been involved with this type of trading since 1985. Our firm is affiliated with the Tiedemann Investment Group of New York, a long established family of hedge funds. Currently, most of our trading is done with the use of NYSE independent brokers. We access them via a NYSE product known as the broker booth system. We are one of a relatively small number of buy-side firms who directly access the floor using "Direct Access" brokers. (More than ten years ago the exchange qualified a number of ex-two-dollar brokers, also known as independents, to be able to do business directly with the buy-side.) Our approach to trading, though not mainstream, employs state-of-the-art technology. We employ independent brokers because we have learned through experience that this is the best way for us to assert our strategy in the market place. Success depends not just on minimizing transactions costs, but also minimizing missed opportunities.

Over the past twenty years, in our pursuit of productivity and efficiency on behalf of our investors, we have experimented and used almost all new trading technologies introduced by the NYSE, and those of other market places, to access liquidity and obtain best price. Frequently we have been the first, or among the first, users of new NYSE technology, including the SuperDot system in the mid 80's, the broker booth routing system (BBS), use of Direct Access to independent brokers, and use of the exchange's capability to route orders to hand-held computers used by brokers on the floor. In this last application we were the first. Though we are not regarded as a particularly large trader we have always enjoyed excellent working relations with the NYSE to learn and use new technologies.

Having gained broad experience with many other exchanges and trading systems through both difficult and easy market conditions, our group has concluded that the NYSE auction system and its numerous evolutionary steps, still represents the best overall system for investors trading listed securities.

On balance I believe the new proposals are constructive and responsive to the need for the exchange to become state of the art while still protecting investors and providing stability during difficult market conditions as well as normal ones.

My comments are broken into two parts: technical and conceptual. The technical comments concern certain aspects of the current NYSE proposal that we think need focus to ensure that the new system works for all parties, with high certainty, from the get-go. The conceptual concerns relate to the broader issue mentioned as the last point made in the paragraph above ("…during difficult market conditions as well as normal ones."), several theoretical points about the characteristics of competitive markets, and the need for testing before implementation.

The stated goals are: (1) Offer greater choice in executing trades; (2) accommodate diverse trading strategies of customers; (3) improve the speed and efficiency of technology by preserving the advantages of human knowledge and expertise. With this in mind my technical comments relate to Rule 70 and Rule 104.

Rule 70.20(f) [Floor broker's interest file cancelled when they have left the Crowd] and 70.30 [Definition of a Crowd]

This set of rules runs in the opposite direction of technology and the quest for greater speed, productivity, and liquidity. Floor brokers are equipped with hand held computers and can act in a virtual capacity at any post where they have customer interest files. To limit them to a distance of five contiguous panels at the same post is arbitrary and unnecessarily restrictive and puts customers who use independent floor brokers at a disadvantage and favors large firms, who possibly could place brokers at every post, over small firms, who could not.

Rule 104 [Specialist ability to establish a Quote API utilizing proprietary algorithms]

The proposal appears constructive as both a potential risk management tool and to speed the process of providing liquidity by specialists. My concern is over the potential for piercing the 'Chinese wall' whereby the data, within the computers running the algorithms and staff monitoring the books across all the specialists within a firm, could be communicated outside the exchange and be seen by upstairs traders or other business units affiliated with the specialists. While this concern may be covered by the parenthetical statement at the conclusion of paragraph (b) of the rule, I believe there should be an affirmative statement concerning this prohibition.

My conceptual concerns are:

Trading systems should be designed to function fairly in difficult market conditions, not just the more prevalent normal conditions.

The specialist-centric auction system historically has demonstrated the ability to do that. A properly designed hybrid NYSE auction system can perform well even when markets are under stress during difficult times and still provide liquidity. One only need think about mid October 1987, when US markets experienced an eight standard deviation decline event. Traders all over the world complained they couldn't trade because they couldn't reach their broker; OTC markets were reported by many as inaccessible, yet those who were linked electronically to the NYSE discovered they could trade. The quote tape was accurate and marketable orders were honored and executed by specialists, bound by their affirmative obligation, to fill orders from their own inventory, even as they were experiencing heavy losses. There are many lesser, but still serious market events that have also illustrated the resilience and efficacy of the people-based, NYSE auction system. The point of focusing on some of the more difficult market situations is to point out that computers alone are not adaptive to new or extreme conditions and cannot make subjective moral obligations. People can do that very well.

Characteristics of competitive markets
There is one price at any moment in time; transactions automatically take place if there is a match between a bid and an offer; and the primacy of disclosed orders. The current NYSE proposals appear to preserve these three very important principles. It would be a mistake, leading to claims of discrimination, to permit a system where trades might take place at different prices at the same time. It would also be a mistake, leading to claims of unfairness and discrimination, if it were optional to fill an order immediately whenever there was a bid/offer match. Finally, in order to encourage market participants to post quotes they must be given primacy if executions take place at their price. That means executed and completed first if there is a bid/offer match.

Testing
Overall the proposals appear sensible, but people and software need to be trained and broken in. No matter how clearly and correctly expressed in a regulation, when written into software a rule may operate differently than expected due to unexpected edge conditions or interactions. Therefore, it is imperative that an adequate testing period be available for all market participants.

Very truly yours,

signed

Gregory van Kipnis