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September 21, 2005

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: SR-NYSE-2004-05 (NYSE HYBRID MARKET[SM] and Amendment Nos. 1, 2, 3 and 5 thereto.

Dear Mr. Katz:

The New York Stock Exchange (the "Exchange" or "NYSE") is writing to respond to thirty-two (32) letters[1] made in response to the Securities and Exchange Commission's

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1 See, Ari Burstein, Associate Counsel, Investment Company Institute, to Jonathan Katz, Secretary, SEC, dated July 20, 2005 ("ICI Letter III"); George U. Sauter, Managing Director, The Vanguard Group, Inc., to Jonathan Katz, Secretary, SEC, dated July 20, 2005 ("Vanguard Letter"); Kim Bang, President and Chief Executive Officer, Bloomberg Tradebook, LLC, to Jonathan Katz, Secretary, SEC, dated July 28, 2005 ("Bloomberg Letter"); George Rutherfurd, Consultant, to Jonathan Katz, Secretary, SEC, dated July 20, 2005 ("Rutherfurd Letter III"); Donald D. Kittell, Executive Vice President, Securities Industry Association, to Jonathan Katz, Secretary, SEC, dated July 20, 2005 ("SIA Letter III"); Junius W. Peake, Monfort Distinguished Professor of Finance, Kenneth W. Monfort College of Business University of Northern Colorado, to Jonathan Katz, Secretary, SEC, dated June 17, 2005 ("Peake Letter II"); George Rutherfurd, Consultant, Chicago, Illinois, to Jonathan Katz, Secretary, SEC, Dated April 8, 2005 ("Rutherfurd Letter II"); George Rutherfurd, Consultant, to Jonathan Katz, Secretary, SEC, dated March 10, 2005 ("Rutherfurd Letter I"); Edward S. Knight, NASDAQ, to Jonathan Katz, Secretary, SEC, dated January 26, 2005 ("NASDAQ Letter"); Marc L. Lipson, Associate Professor, Terry College of Business, University of Georgia, to Jonathan Katz, Secretary, SEC, dated January 4, 2005; William R. Power, Member and Director, Chicago Board Options Exchange, Chicago, Illinois, to Jonathan Katz, Secretary, SEC, dated December 21, 2004 ("CBOE Letter II"); Thomas Peterffy, Chairman and David M. Battan, Vice President, Interactive Brokers Group, to Jonathan Katz, Secretary, SEC, dated December 14, 2004 ("IBG Letter II"); Ann L. Vlcek, Vice President and Associate General Counsel, Securities Industry Association, to Jonathan Katz, Secretary, SEC, dated December 13, 2004 ("SIA Letter II"); Ari Burstein, Associate Counsel, Investment Company Institute, to Jonathan Katz, Secretary, SEC, dated December 13, 2004 ("ICI Letter II"); Gregory van Kipnis, Managing Partner, Invictus Partners, LLC, to Jonathan Katz, Secretary, SEC, dated December 10, 2004

(the "Commission" or "SEC") solicitation of comments in connection with the NYSE HYBRID MARKET[SM] ("Hybrid Market") filing and Amendment Nos. 1, 2, 3 and 5 thereto.[2] A number of comments raised in earlier letters were addressed in subsequent

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("Invictus Letter"); Eric D. Roiter, Senior Vice President and General Counsel, Fidelity Management & Research Company, to Jonathan Katz, Secretary, SEC, dated December 8, 2004 ("Fidelity Letter III"); Philip Angelides, Treasurer, State of California, to Jonathan Katz, Secretary, SEC, dated November 23, 2004 ("Angelides Letter"); Eric D. Roiter, Senior Vice President and General Counsel, Fidelity Management & Research Company, to Jonathan Katz, Secretary, SEC, dated October 26, 2004 ("Fidelity Letter II"); Edward J. Nicoll, Chief Executive Officer, Instinet Group Incorporated, to Jonathan Katz, Secretary, SEC, dated October 25, 2004 ("IGI Letter"); Donald D. Kittell, Executive Vice President, Securities Industry Association, to Jonathan Katz, Secretary, SEC, dated October 1, 2004 ("SIA Letter I"); Bruce Lisman, Bear, Stearns & Co., Inc., to Jonathan Katz, Secretary, SEC, dated September 28, 2004 ("Bear Letter"); George W. Mann Jr., EVP & General Counsel, Boston Stock Exchange, to Jonathan Katz, Secretary, SEC, dated September 22, 2004 ("BSE Letter"); Lisa M. Utasi, President and Kimberly Unger, Executive Director, Security Traders Association of New York, Inc., to Jonathan Katz, Secretary, SEC, dated September 22, 2004 ("STA of NY Letter"); Ellen L.S. Koplow, Executive Vice President and General Counsel, Ameritrade, Inc., to Jonathan Katz, Secretary, SEC, dated September 22, 2004("Ameritrade Letter"); Kim Bang, President and Chief Executive Officer, Bloomberg Tradebook LLC, to Jonathan Katz, Secretary, SEC, dated September 22, 2004 ("Bloomberg Letter I"); Ari Burstein, Associate Counsel, Investment Company Institute, to Jonathan Katz, Secretary, SEC, dated September 22, 2004 ("ICI Letter I"); Junius W. Peake, Monfort Distinguished Professor of Finance, Kenneth W. Monfort College of Business University of Northern Colorado, to Jonathan Katz, Secretary, SEC, dated September 22, 2004 ("Peake Letter I"); Jose L. Marques, Ph.D., Managing Member, Telic Management LLC, Greenwich, Connecticut, to Jonathan Katz, Secretary, SEC, dated September 21, 2004 ("Telic Letter"); Thomas Peterffy, Chairman and David M. Battan, Vice President, Interactive Brokers Group, on behalf of its affiliates Timber Hill LLC and Interactive Brokers LLC, to Jonathan Katz, Secretary, SEC, dated September 7, 2004 ("IBG Letter I"); Donald E. Weeden, to Jonathan Katz, Secretary, SEC, dated August 31, 2004 ("Weeden Letter"); James L. Rothenberg, Esq., New York, New York, to Jonathan Katz, Secretary, SEC, dated August 30, 2004 ("Rothenberg Letter"); Eric D. Roiter, Senior Vice President and General Counsel, Fidelity Management & Research Company, to Jonathan Katz, Secretary, SEC, dated August 10, 2003 ("Fidelity Letter I"). The Exchange is not responding directly to the letter from Marc L. Lipson, Associate Professor, Terry College of Business, University of Georgia, to Jonathan Katz, Secretary, SEC, dated January 4, 2005, as this letter is a study rebutting the letter from Eric D. Roiter, Senior Vice President and General Counsel, Fidelity Management & Research Company, to Jonathan Katz, Secretary, SEC, dated December 8, 2004 and therefore, does not directly address any particular proposal described in the filings.

2 See Securities Exchange Act Release No. 50173 (August 10, 2004), 69 FR 50407 (August 16, 2004) (Amendment No.1 to SR-NYSE-2004-05); Securities Exchange Act Release No. 50667 (November 15, 2004), 69 FR 67980 (November 22, 2004) (Amendment Nos. 2 and 3 to SR-NYSE-2004-05); (The Exchange withdrew Amendment

amendments.[3] In addition, Amendment No. 6[4] responds to comments relating to two of the Exchange's proposals, by modifying rules relating to the standing of orders during a sweep and specialist algorithmic price improvement.[5] This letter responds to the substantive comments on the Exchange's proposal, including those made regarding such topics as the NYSE Floor Broker Agency Interest File℠ ("Floor broker agency interest" or "broker agency interest") and the related concepts of reserve and minimum display requirement, Floor brokers' discretionary order, definition of crowd, priority, parity, precedence and yielding (including Exchange Rule 108), standing of orders during a sweep, NYSE Specialist Interest Files℠ and NYSE Specialist API℠ ("Quote API" or "API"), specialist reserve, algorithmic price improvement, and trade-throughs and order protection.

Background

The NYSE HYBRID MARKET℠ (the "Hybrid Market") integrates in one marketplace the best of both auction market and electronic trading. The Hybrid Market combines the benefits of specialist and Floor broker expertise with the speed, certainty, and anonymity of electronic execution to create a trading platform offering maximum choice to customers without eliminating time-tested trading procedures that have proven immensely successful in providing stable, liquid, and less volatile markets.

The Hybrid Market provides more execution choices than exists in any other equities market. Customers who want execution speed and certainty, with anonymity, can opt to have their orders automatically executed via NYSE Direct+® ("Direct +"), the Exchange's electronic trading facility. Customers who want the opportunity for price improvement or the benefit of Floor broker expertise in the handling of their orders can

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No. 4 and replaced it with Amendment No. 5); Securities Exchange Act Release No. 51906 (June 22, 2005), 70 FR 37463 (June 29, 2005) (Amendment No. 5 to SR-NYSE-2004-05).

3 For example, several commenters requested clarification on specialist interest files, algorithms, floor broker agency interest, reserve interest, sweeps, LRPs, auction limit orders, gapping the quote, and trading examples. See, e.g., SIA Letter II, at 6; IBG Letter I, at 2; Fidelity Letter I, at 2; Telic Letter, at 1; Ameritrade Letter, at 1,3; ICI Letter I, at 2-3; STA of NY Letter, at 3-7, BSE Letter; Fidelity Letter II; Bear Letter, at 2-3; SIA Letter I, at 6; NASDAQ Letter, at 6-7; Angelides Letter, at 1; SIA Letter III, at 2. These were responded to by Amendment No. 2, Exhibit 1 – pages 24-46, and Exhibit 3 thereto, and Amendment No. 5, Exhibit 1 – pages 36-58, 61, and Exhibit 5 thereto.

4 See Amendment No. 6 to SR-NYSE-2004-05.

5 A number of comment letters addressed one or both of these issues. See, e.g. Rothenberg Letter, at 1; Telic Letter, at 1; Bloomberg Letter I, at 4-7; Ameritrade Letter, at 4; SIA Letter I, at 3; Rutherfurd Letter I, at 6-7, 11, 15-16; Peake Letter II, at 1; Vanguard Letter, at 2, fn. 3; ICI Letter III, at 2; Rutherfurd Letter III, at 6-8,13, 21-23, 27.

choose to utilize the traditional benefits of the auction process. Moreover, even those choosing to have their orders handled in the auction market initially will still be able to participate in automatic executions, thereby expanding their execution opportunities.

Combining the Exchange's sophisticated technology with the advantages of the auction will enable the market to function more effectively and efficiently. In the Hybrid Market, specialists and brokers will interact with the market electronically as well as in person. Interaction between Floor brokers and specialists serves as a catalyst to trading and both functions are integral to the success of the Hybrid Market. Specialists and Floor brokers will continue to perform their vital functions through the use of Floor broker agency interest files, specialist layered interest files, and specialist algorithmic interaction with orders. As such, both electronically and manually executed orders will benefit from the value added by specialists in committing capital and providing depth to the market in response to customer demands, and the competition among orders represented by Floor brokers in the Crowd. Human judgment is particularly valuable in less-liquid securities, during the opening and closing of trading and during times of uncertainty, such as when an earnings surprise, news, or an outside event leads to market volatility and/or instability and results in the reduced volatility, stable prices, and fair and orderly markets that are hallmarks of the Exchange.

The proposed enhancements to Direct+ are responsive to customer requests for greater electronic access to the liquidity on the Exchange. Market and limit orders of all sizes will be able to be executed via Direct+. Customers will no longer be subject to the 30-second restriction between orders. Conditions that suspended automatic executions (such as a 100-share bid or offer) will be eliminated and customers will be able to access automatically additional liquidity within a specified price range during the sweep.

In addition, the Hybrid Market includes new opportunities for price improvement via auction limit orders and market orders not designated for automatic execution ("auction market orders"), which also incorporate the possibility of automatic execution. Similarly, the Hybrid Market continues the ability of customers to benefit from Floor broker expertise. Floor brokers will be able to use new trading tools that will increase their options in handling their customers' orders, such as the Floor broker agency interest file and a discretionary order, which will be the subject of a separate filing. Specialists also will be able to use new trading tools that will allow them to participate in electronic trading.

The proposals set forth in the Exchange's Hybrid Market filings will make for better markets to the benefit of all, encourage the display of liquidity, and allow customers to access this liquidity in whatever way best suits their needs. As such, the Hybrid Market proposal ensures the continuation of the stable, liquid markets for which the Exchange is known.

Floor Broker Agency Interest File - Exchange Rule 70.20

Several letters commented on the Floor broker agency interest file[6], suggesting it provides an unfair advantage to brokers and questioning the appropriateness of its parity with orders on the Display Book®.[7]

NYSE Floor Brokers Agency Interest Files will enable Floor brokers to electronically represent agency interest at various prices at or outside the Exchange quote with respect to orders they are handling. This functionality allows customers to reap the benefits of Floor broker knowledge and trading expertise combined with the efficiencies of automatic executions. Floor brokers will be able to represent effectively interest that their customers do not wish to display, but at the same time, this interest will be able to be accessed by incoming orders and participate in automatic executions and sweeps and thus, not "miss the market."

The broker agency interest file serves the public interest by giving a customer the ability to benefit from Floor broker experience and trading expertise in determining the best way to represent such customer's order, while not precluding them from participating in electronic executions and sweeps. It gives customers choice and Floor brokers flexibility in representing orders over time at the point of sale, thereby maximizing brokers' ability to obtain the best execution possible consistent with the customer's instructions. Further, the agency interest file allows customers to provide liquidity within a specified price range while moderating the volatility that might normally result from an order of size.

Broker agency interest will not be disseminated unless it is at the Exchange best bid or offer ("BBO"). Neither the individual specialist on the Floor nor the specialist's algorithms will have access to any information about specific orders in Floor broker agency interest files. Only the specialist on the Floor will have access to limited information pertaining to interest in the files. The specialist will not know the number of customer orders behind such volume, who the orders are for, which brokers represent the orders or the limit prices for such orders. Specialists will be able to view only total aggregated broker agency interest at each price, except for any interest a broker has

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6 See, e.g., Telic Letter, at 1; Bloomberg Letter I, at 5; ICI Letter I, at 4; ICI Letter II, at 1-3; ICI Letter III, at 4; Rutherfurd Letter I, at 3-6, 8-9, 15-16; Rutherfurd Letter III, at 7, 13-14; SIA Letter I, at 2; Vanguard Letter, at 3.

7 The Display Book® ("Display Book" or "book") is an order management and execution facility that receives and displays orders to the specialist and provides a mechanism to execute and report transactions and publish the results to the Consolidated Tape. In addition, the Display Book is connected to a variety of other Exchange systems for the purposes of comparison, surveillance, and reporting information to customers and other market data and national market systems (i.e. the Intermarket Trading System, Consolidated Tape Association, Consolidated Quotation System, etc.).

elected not to have disclosed to the specialist. Specialists need to know the amount of buy and sell interest at each price in order to fulfill their obligation to maintain a fair and orderly market and to determine appropriate prices in manual trading situations, such as after a gapped quote or when a liquidity replenishment point has been reached. Specialists are thus not given an advantage over other market participants, as one commenter has stated they would receive.[8] Moreover, a broker can elect to exclude his or her agency interest from the aggregate disclosed to the specialist without jeopardizing such interest from participating in automatic executions. Similarly, Floor brokers will only have access to information pertaining to their own agency interest. They will not have access to other broker's files.

Accordingly, the Floor broker agency interest file benefits customers who choose not have their interest displayed or who want the opportunity for price improvement that auction market trading provides, yet want the possibility of participating in automatic executions. It also benefits those customers who prefer to have a Floor broker manage their orders to obtain the best execution possible consistent with such customer's instructions, rather than having to decide when and how to execute their order flow themselves.

Floor Broker Reserve/Minimum Display Requirement – Exchange Rule 70.20

Some comment letters question whether the reserve feature of Floor broker agency interest grants too much advantage to Floor brokers.[9]

The existence of reserve interest is not unique to the Exchange. Indeed, all electronic order books have reserve functionality at all price levels, not just at the BBO.[10] The reserve functionality allows Floor brokers to use their skills to determine the best way to represent their customer's interests and to weigh the benefits of disclosing partial or full interest. The reserve functionality protects customers by allowing them to access both the auction market and automatic executions and thereby reap the opportunity of benefiting from both types of executions, without the risk of "missing the market." Further, the reserve feature benefits the marketplace as a whole by providing liquidity and dampening price volatility. As such, the existence of a reserve feature as part of the Hybrid market is consistent with facilities available in other markets and clearly benefits customers.

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8 See, e.g., ICI Letter II, at 3.

9 See, e.g., Bloomberg Letter I, at 5; SIA Letter I, at 2; Rutherfurd Letter I, at 3-7, 13, 16; Vanguard Letter, at 3; ICI Letter III, at 2, 4.

10 See, e.g., Securities Exchange Act Release No. 46410 (August 23, 2002), 67 FR 55897 (August 30, 2002) (File No. SR-NASD-2002-56) (Nasdaq SuperMontage Filing).

In order to have reserve interest, which is Floor broker agency interest at the BBO that is not included in the published size associated with the BBO, a Floor broker must be displaying a minimum of 1,000 shares at the Exchange BBO. A Floor broker has discretion to display more than 1,000 shares at the BBO but may not display less and maintain reserve interest. Reserve interest yields to displayed interest in the Exchange BBO, but participates in automatic executions at that price provided there is sufficient contra-side liquidity. An automatically executing order trades with the displayed interest at the BBO first and then with any reserve interest at that price before sweeping the book. Thus, reserve interest benefits incoming orders by providing more liquidity at the BBO.

The reserve feature is available to all investors through Floor brokers. Customers seeking to participate in the reserve interest file will be able to do so by sending their orders to Floor brokers with appropriate instructions as to how they want their orders handled.

Input from customers reflected that they would not be able to aggregate liquidity as effectively if a reserve feature was not offered, comparable to that offered by other market centers. The Exchange believes that a reserve feature for on-Floor participants, rather than off-Floor participants, provides an incentive for participating in price discovery at the point of sale, without replicating ECN functionality.

Definition of Crowd – Exchange Rule 70.30

One comment letter took issue with the Exchange's proposed definition of "Crowd" as being unduly restrictive.[11]

Floor brokers are permitted to have agency interest files "at multiple price points on both sides of the market at or outside the Exchange best bid and offer with respect to each security trading in the location(s) comprising the Crowd such Floor broker is a part of with respect to orders he or she is representing on the Floor…." See Exchange Rule 70.20(a). Exchange Rule 70.30, in turn, defines a Crowd as "one of five contiguous panels at any one post where securities are traded."

Today, a Floor broker has to be in the Crowd in order to participate in the auction. The Floor broker agency interest file allows the Floor broker to continue participation in an auction, but in an automatic execution environment. The Exchange believes that an appropriate balance has been drawn between enhancing the ability of a Floor broker to represent his or her customer orders effectively in the Hybrid Market with the need for the broker to effectively and efficiently participate in auction market trading. In addition, the Exchange believes that the range of five contiguous panels in the definition of Crowd represents the appropriate range of proximity to enable brokers to also participate in the

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[11] See, e.g., Invictus Letter, at 2.

auction market. The Exchange will revisit this definition as it gains experience with the Hybrid Market.

If a Floor broker must leave the Crowd, and therefore cancel his or her agency interest file, the broker can ensure that his or her customers' orders are still represented in that Crowd by sending such orders with his or her choice of execution instructions[12] from the broker's NYSE e-Broker® handheld device[13] to the specialist through an Exchange order management system, such as Broker Booth Support System® ("BBSS")[14] or a proprietary system. Brokers can also opt to send orders via their handheld devices to Direct+ for automatic execution or transfer the orders to another member for representation in the Crowd.

Priority, Parity, Precedence and Yielding – Exchange Rule 108
A number of letters commented on the Exchange's proposed rules relating to priority, parity, precedence, and yielding under the Exchange Rules 72, 104, and 108.[15]

A summary of the rules regarding priority, parity, precedence, and yielding among automatically executing orders are listed below, in their order of execution:

- Displayed interest[16] at Exchange best bid or offer

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[12] For example, a Floor broker may choose to send the specialist a CAP-DI order. A CAP-DI ("convert and parity") order is a form of percentage order. A CAP-DI order is elected when a transaction occurs at its limit price or a better price. In addition, a CAP-DI order instruction permits the specialist to convert all or part of the order on any tick Any elected portion of a CAP order is to be executed immediately in whole or in part, and that whatever is not immediately executed does not remain on the book as a limit order, but reverts to its status as an unelected percentage order for future election or conversion.

[13] The NYSE e-Broker® handheld devices ("HHD") enable Exchange Floor brokers to communicate electronically with their booths and customers (through their booths). The application provides the ability to receive orders, report executions, communicate market looks and order status to customers and receive market data at the point-of-sale.

[14] BBSS is an order-management system designed exclusively for NYSE members, which enables member firms to process and manage their orders quickly and efficiently and to selectively route orders via SuperDot® directly to the trading post, the broker's handheld device, or the booths on the Trading Floor.

[15] See, e.g, ICI Letter I at 4; Bloomberg Letter I at 4, 6-7; ICI Letter II at 2; Rutherfurd Letter I at 4-6, 8, 15; Vanguard Letter at 3; SIA Letter III at 2; Rutherfurd Letter III at 12-17.

[16] Displayed interest at Exchange BBO is the published volume associated with the NYSE's best bid and offer.

- Within this category, the order of execution is:
  - Interest that clearly established the best bid or best offer
    - Except: specialist interest that clearly established the best bid or offer yields to all after-arriving limit orders on the Display Book®
    - If there are no limit orders on the book at the best bid or offer, specialist interest that clearly established the best bid or offer is entitled to priority with respect to the Crowd for one trade.
  - All other displayed interest at the best bid or offer
    - Trades on parity
    - Except: specialist interest displayed at best bid or offer cannot trade until all limit orders on the book at the best bid or offer are filled
    - If there are no limit orders on the book at the best bid or offer, specialist interest displayed at that price trades on parity with any remaining Crowd interest displayed at the best bid or offer
    - Specialist ability to trade on parity with the Crowd is not restricted by the specialist's proprietary position (i.e. the specialist trades on parity whether establishing/increasing or liquidating/decreasing its position). See discussion on Exchange Rule 108, below.

- Reserve interest (i.e. non-displayed interest) at the best bid or offer
  - All reserve interest trades on parity
- Additional specialist interest (i.e. non-displayed interest) at the best bid or offer
  - Trades only if no other interest exists at best bid or offer.
  - Allows specialist to facilitate a single-price execution or to provide more liquidity at the best bid or offer price
- Interest that participates in the sweep (i.e. limit orders on the book, broker agency interest and specialist interest, if any, at prices outside the best bid or offer through the sweep clean-up price)
  - At the sweep clean-up price, the amount of Floor broker agency interest that would have been displayed had there been a new quote at that price will trade on parity with displayed interest, e.g. orders on the book, at the clean-up price. The amount of any broker agency interest that would have remained in the broker's reserve will yield to displayed interest.

        - This is a change from prior filings, in response to comment letters and discussions with various constituents and is discussed in more detail below
    - Specialist interest participates in the sweep provided there are no limit orders on the book interest remaining at the sweep clean-up price.
        - Specialist interest participating in the sweep trades on parity with broker agency interest at the sweep clean-up price.

The Exchange believes that, taken as a whole, the proposals relating to priority, parity, precedence, and yielding that are discussed in the Hybrid Market filings – essentially that displayed interest always trades first (other than specialist displayed interest which yields to limit orders on the book) and that non-displayed interest trades on parity is fair and appropriately balances the interests of all market participants. Moreover, it is consistent with the way other markets operate.

<u>Standing of Orders during a Sweep – Exchange Rules 72, 104, and 108</u>

Some letters commented on the standing of orders during a sweep (limit orders on the book vs. floor broker agency interest vs. specialist interest), in particular that floor broker agency interest would be executed on parity with limit orders on the book, which are required to be displayed in full.[17]

Previous amendments to SR-NYSE-2004-05 described the sweep process. After trading with all interest at the Exchange BBO (including displayed interest, reserve interest, and additional specialist interest, which participates in an execution in the manner described above), an "auto ex" order (i.e. an order specifically entered for automatic execution or one that will be handled that way)[18] will then "sweep the book" trading with orders on the book, Floor broker agency interest, and specialist interest, at prices outside the BBO, until filled, a LRP is reached or, if an auto ex limit order, its limit price is reached. Orders on the book, Floor broker interest and any specialist interest trading with the sweeping auto ex order will receive the sweep clean-up price.

Previous amendments noted that during a sweep, Floor broker agency interest and orders on the book at prices outside the BBO trade on parity with each other. Specialist interest is able to participate in a sweep and trade on parity with Floor broker interest provided

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17 <u>See, e.g.,</u> ICI Letter I, at 4; Ameritrade Letter, at 4; Rutherfurd Letter I, at 15-16; Rutherfurd Letter III, at 6-7.

18 For example, a market order is an "auto ex" order if it designated as such when entered, whereas a limit order that is marketable when it arrives at the Exchange will be deemed to be an "auto ex" order without the need for specific designation.

orders on the book at the sweep clean-up price have been filled. After discussing the matter further with Exchange constituents and in response to written comments,[19] the Exchange has proposed amended rules revising the standing of orders on the book and Floor broker agency interest during a sweep.[20] These amendments are consistent in approach with the concept that displayed interest at each price point will execute before non-displayed interest at the same price point and the corollary principle that non-displayed interest at a better price may trade ahead of displayed interest at a worse price, while taking into account the fact that during a sweep there is no opportunity for broker agency interest at the clean-up price to be displayed before the execution that occurs at that price.

Accordingly, at the sweep clean-up price, the amount of Floor broker agency interest that would have been displayed had there been a new quote at that price will trade on parity with displayed interest, e.g. orders on the book, at the clean-up price. The amount of any broker agency interest that would have remained in the broker's reserve will yield to displayed interest. For example, if a broker has 10,000 shares at the sweep clean-up price, and had designated previously that all should be displayed if that price becomes the BBO, all 10,000 shares will trade on parity with the book. However, if the broker had designated previously that only 2,000 of the 10,000 shares should be displayed, with the remaining 8,000 shares in reserve, 2,000 shares will trade on parity with the book and the 8,000 shares will yield. See also examples in Amendment No. 6.

Exchange Rule 108(a)

One comment letter took issue with the ability of a specialist to trade on parity with the Crowd regardless of the specialist's existing position,[21] as proposed in amendments to Exchange Rule 108(a).

Current Exchange Rules 72, 104, and 108 require that specialists, when trading for their proprietary accounts, yield to limit orders on the Display Book in all circumstances. When liquidating or decreasing a position, specialists must yield to the Crowd upon the request of a customer.[22] When establishing or increasing a position, Rule 108(a) provides that specialists are not entitled to trade on parity with the Crowd. However, under current practice, based on the Exchange's interpretation of Rule 108(a), brokers in the Crowd

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19 See, e.g., Ameritrade Letter, at 4; Rutherfurd Letter I, at 15-16; Peake Letter II, at 1; Rutherfurd Letter III, at 6-7.

20 See Amendment No. 6 to SR-NYSE-2004-05.

21 See, e.g., Rutherfurd Letter III, at 16-17.

22 See Exchange Rule 104.10(6)(i)(C).

may permit the specialist to be on parity with their orders.[23] Parity is an incentive for participating in the price discovery process at the point of sale. It has the beneficial effects of dampening volatility and lowering execution costs for investors.

In Amendment No. 5, the Exchange proposed to amend Rule 108(a) to eliminate that restriction and provide that with respect to automatic executions, specialists would be entitled to parity with orders represented in the Crowd and agency interest files when establishing or increasing their position.

Floor brokers are frequently given permission by their customers to use discretion in executing their orders, consistent with the broker's understanding of the customer's general execution requirements. For example, some customers prefer not to participate in a transaction below or above a certain size or do not want to be the sole contra-party to an execution, particularly if such execution is at a new price. In such a case, the customer's concern is only that someone else trade alongside and therefore is likely indifferent as to whether that party is the specialist or another customer. A broker may determine that allowing the specialist to trade on parity is consistent with his or her customer's instructions and "best execution" obligations. For example, the order contains instructions that would accommodate the specialist trading on parity, such as where the customer instructs the broker not to trade more than a fixed number of shares on any single trade (and where the total contra-interest in the particular trade exceeds that fixed amount), or where a broker holding a large order is nevertheless trading less than the contra-side interest in a given trade because the terms of the customer's order limits the broker to a fixed volume over a particular period of the trading day.

The Exchange believes that in a hybrid environment involving more automatic execution availability, the specialist's position should not dictate whether he or she is on parity with the Crowd. The proposed amendment codifies the Exchange's interpretation of Rule 108(a) and corresponds to the flexibility needed by Floor brokers to effectively represent orders in accordance with their customers' instructions.

In addition, it is consistent with other Exchange rules that permit specialists to trade on parity with the Crowd, such as Exchange Rule 123A.30, [24] which expressly authorizes

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23 Specialists establishing the best bid or offer are entitled to priority over the Crowd for one trade. An exception is made for so-called "G" orders, which are orders that originate off the Floor and are executed pursuant to Section 11(a)(1)(G), 15 U.S.C. Sec. 78k(a)(1)(G) of the Securities Exchange Act of 1934 (the "SEA") and SEA Rule 11a1-1(T), 17 C.F.R. Sec. 240.11a-1(T), thereunder.

24 Exchange Rule 123A.30 limits the specialist's ability to be on parity by providing that the specialist may not participate in an amount in excess of what each CAP order would receive, except that the specialist may participate to an extent greater than any particular CAP-DI order where the size specified on such order has been satisfied. The execution of CAP orders and the specialist's participation in

brokers to permit specialists to go along on CAP orders, regardless of whether the specialist is increasing or decreasing his position. Similarly, as noted above, specialists are entitled to trade on parity with the Crowd when liquidating or decreasing a position,[25] subject to the same kind of broker permission that is required in connection with Exchange Rule 108(a).

Specialist's Negative Obligation – Exchange Rule 104.10

One commenter opined on the connection between a specialist's ability to participate on parity with the Crowd when establishing or increasing a position and their negative obligation.[26]

Specialists on the Exchange differ from market makers on other market centers in that they cannot just hit bids and/or take offers. Instead, specialists commit capital, thereby providing depth, lowering volatility and execution costs for investors.

The negative obligation, which is part of Exchange Rule 104.10, requires that the specialist provide an opportunity for public orders to be executed against each other without undue dealer intervention within the context of the current market, and that the specialist not deal in a manner that is inconsistent with the overall objective of maintaining a fair and orderly market. Specifically, Rule 104.10(3) provides that:

> "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 to contribute to the maintenance of price continuity with reasonable depth, and to minimizing 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 negative obligation incorporated into Rule 104.10 controls the specialists' ability to trade, regardless of whether the specialist is establishing/increasing a position or liquidating/decreasing a position. Of course, this obligation will continue to apply in the hybrid market to all specialist trading, whether or not such trading is entitled to parity. As such, the Exchange believes that the distinction from a parity perspective between establishing/increasing a position versus liquidating/decreasing a position does not

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these executions will be automated so that the system assigns the proper number of shares to the specialist. See SR-NYSE-2005-57 (August 10, 2005). Similarly, specialist participation in executions pursuant to Rule 108(a) and 104.10(6)(i)(C) will be handled systemically.

25 See NYSE Rule 104.10(6)(i)(C).

26 See, e.g., Rutherfurd Letter I, at 16; Rutherfurd Letter III, at 11-12, 16.

impact or compromise the application and operation of the negative obligation to specialist trading.

Algorithm -- Quote API -- Rules 104, 92, and 36

A number of comment letters received by the Commission discussed the NYSE Specialist API ("Quote API").[27]

Specialists provide significant value to the market: they commit capital to narrow quotes, add liquidity, and stabilize prices.[28] To assist specialists in this effort and to enable them to comply more readily with their market-making obligations in an environment of increased electronic trading, the proposed Hybrid Market rules provide specialists with the ability to implement external application programmed interfaces ("API"), which will transmit to the book messages generated by a system employing pre-set proprietary algorithms to quote or trade on behalf of their dealer accounts. This algorithmically-based trading and quoting will be permissible only in certain, limited ways. By allowing specialists to do electronically that which they are able to do manually today, specialists will be able to continue to provide value and liquidity in the Hybrid Market.

Several letters commented that the specialist's ability to algorithmically trade and quote would put the specialist at an informational advantage over other market participants and, thereby, raises issues of transparency and fairness.[29]

Algorithmic trading is the way in which specialists will be able to participate in the Hybrid Market and continue to perform their market-making obligations in an efficient and effective manner. Without this ability, specialists will have distinct difficulty fulfilling their obligations to maintain liquid and continuous two-sided markets that are fair, orderly and competitive. They will be unable to ensure that there is appropriate price continuity and depth, in which price movements are accompanied by appropriate volume and unreasonable price variations between trades are avoided.

The specialists' systems that will enable algorithmic trading will not be privy to any more or different information than specialists have today. In the Hybrid Market, the specialist's algorithm will have to function according to the rules and take predetermined

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27 See, e.g., Bloomberg Letter I, at 5; Invictus Letter, at 2-3; Rutherfurd Letter I, at 11-12, 15; Vanguard Letter, at 2; ICI Letter III, at 3; SIA Letter III, at 2; Rutherfurd Letter III, at 7, 16, 21-25.

28 Currently, specialists provide approximately 9% of total volume, approximately 80% of which is stabilizing in nature.

29 See, e.g., Telic Letter, at 1; Vanguard Letter, at 2; ICI Letter III, at 3; SIA Letter III, at 2; Rutherfurd Letter III, at 20.

actions before an order arrives, which takes into account the size and price of an order in order to determine if the algorithmic action meets the criteria for execution. For example, in order to fulfill their obligations, specialists today have knowledge of incoming orders, as well as CAP and stop orders. Specialists' algorithmic trading is strictly controlled, limited to a relatively few circumstances (trading actions and quoting actions, as detailed in Amendment No. 5). The requirements detailed in proposed Exchange Rules 104(b) – (h) for algorithmic trading will be enforced systemically and, in some ways, are more restrictive than current auction-market rules.

For example, to ensure that an algorithmically-generated message to trade with the Exchange published quotation (i.e., hit a bid or take an offer) does not have an advantage because the specialist's system was aware of an incoming order that will cause a change to the BBO before such new bid or offer is disseminated, the algorithmically-generated message will not be processed by the book until after such new bid or offer has been publicly disseminated, thereby giving all market participants an opportunity to trade with such bid or offer.

To ensure that an algorithmically-generated message to hit a bid or take an offer does not possess any speed advantage in reaching the Display Book, Exchange systems will make certain that such messages are processed by the book in a manner that gives specialists and other market participants, such as upstairs traders, a similar opportunity to trade, by delaying processing of the algorithmically-generated message for a period based upon the average transit time from the Common Message Switch ("CMS")[30] system to the book. The delay parameter will be adjusted periodically to account for changes to the average transit time resulting from capacity and other upgrades to Exchange systems.

In addition, as per proposed Exchange Rule 104(g), neither the specialist on the Floor nor the system issuing algorithmically generated messages will have the ability to affect the order in which algorithmically generated messages and incoming orders are processed by the book.[31]

One commenter[32] appears to be under the impression that orders must go through the specialist's trading system before it is sent to the book for processing. To clarify, an

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30 CMS is a store-and-forward message-switching application that connects member firms to Exchange systems. CMS validates and routes orders from member firms to the SuperDot system and into the Display Book system, which then processes them. Algorithmically-generated messages will be delivered to the Display Book via a different set of Exchange systems.

31 The Exchange has proposed that the specialist be allowed to interact with their algorithms from the Floor via a wired or wireless device, such as a computer terminal or laptop. The Exchange notes that no comments were received regarding this proposal.

32 See, e.g., SIA Letter III, at 2.

incoming order will not be delayed in its arrival at or processing by the book. A copy of the order will go to the specialist's system and the actual order will continue on its path to the book for processing. To illustrate, once an order is received by the Secure Financial Transaction Infrastructure (SFTI),[33] it goes through the Consolidated Message Switch (CMS),[34] through SuperDot (with a copy, not the original, to the algorithm), then to the Exchange's Post Support System (PSS),[35] and onto the Display Book. These steps, which take an average of 350 milliseconds, are in the public interest, ensuring that the customer's order is reliably filed in our database of record. In addition, this order routing satisfies Regulation NMS's definition of "automated quotation," which incorporates three elements: (1) acting on an incoming order; (2) responding to the sender of the order; and (3) updating the quotation. The definition of automated quotation does not set forth a specific time standard; rather, a trading center's systems should provide the fastest response possible without any programmed delay.[36] Certainly, the 350 milliseconds on average it takes to ensure safety and accuracy for incoming customer orders, with no human intervention or decision making involved in the process, protects customers, ensures fair markets, and is consistent with the requirements of Regulation NMS.

Algorithmically-generated messages provide for better audit trail data for use by New York Stock Exchange Regulation by systemically capturing detailed information regarding such messages and the systems within which they operate. In addition, the proposed rules require the production of information and documentation regarding the specialists' systems that will also assist in the appropriate regulation of their algorithmic trading.[37]

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33 SFTI is a private communications network for the financial industry that is designed to be more resistant to man-made and natural disasters, while speeding recovery after a crisis. This highly reliable network offers firms access to SIAC for the New York Stock Exchange, the American Stock Exchange, Clearing Corporation and Market Data services. SFTI B2B, available through SIAC's subsidiary, Sector, Inc., utilizes the SFTI infrastructure to carry order traffic and other financial data to additional Exchanges, Market Centers & Content Service Providers.

34 CMS is a store-and-forward message-switching device that connects member firms to Exchange systems. CMS forwards orders from member firms to the SuperDot® system, which then processes them.

35 PSS links a Local Area Network (LAN), allowing data to be transmitted to trading floor devices.

36 See SEC Rule 600(b)(3); See also Securities Exchange Act Release No. 51808 (June 9, 2005), 17 CFR 200, 201, 230, 240, 242, 249, and 270 at 88-89.

37 For example, proposed Exchange Rule 104(f)(ii) requires that specialists notify the Exchange in writing within such time as the Exchange shall designate,

To ensure that the specialists' ability to trade algorithmically is consistent with the expectations of market participants, the Exchange plans to introduce a committee composed of representatives of the various Exchange constituencies that will review hybrid functionality based upon data and experience, including specialist trading data. A comment letter received by the SIA stated that it viewed this proposal as a "positive step." [38]

While one commenter has criticized the Exchange's proposal by asserting that algorithmic price improvement of one cent is "penny-jumping,"[39] the fact remains that the ability of the specialist to provide price improvement of one cent when the quotation spread is two cents is consistent with federal securities laws and Exchange rules. Neither federal securities laws nor Exchange rules prohibit any market participant from bidding, offering, or trading one cent (i.e. the minimum variation) better than an existing bid or offer.

Specialist Reserve

One comment letter questioned the ability of specialists to maintain reserve interest.[40]

Proposed Exchange Rule 104 provides that specialists may, but are not required to, have non-displayed reserve interest at the BBO. The specialist must display a minimum amount, 2,000 shares, of interest displayed at the BBO, in order to have reserve interest on that side of the market.

The Exchange believes that reserve interest benefits the marketplace in the same way that Floor broker reserve interest does, discussed above. In addition, by requiring the specialist to display a minimum of 2,000 shares at the BBO in order to have reserve interest, the proposal ensures the display of additional liquidity at the BBO.

NYSE Specialist Interest Files

One comment letter expressed concern about the transparency of NYSE Specialist Interest Files.[41]

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whenever an algorithm is not operating and the time, cause, and duration of such non-operation.

38 See, e.g., SIA Letter III, at 2.

39 See, e.g., Rutherfurd Letter III, at 21.

40 See, e.g., Rutherfurd Letter III, at 7.

41 See, e.g., Bloomberg Letter I, at 2, 4-5.

The specialist interest file allows specialists to provide added value by committing capital and layering the book outside the BBO. Such interest will benefit the marketplace by increasing liquidity at prices outside the BBO bridging temporary gaps in supply and demand, dampening volatility, and potentially improving sweep prices. Thus, the specialist interest file offers many of the same benefits as the broker agency interest file, discussed above.

Furthermore, in order to address concerns regarding the transparency of such specialist interest, the Hybrid Market proposal[42] provides that specialists may include their interest away from the BBO in the aggregate price/volume information disseminated via NYSE OPENBOOK®.[43]

Specialists' Ability to Systemically Price Improve Incoming Orders – Exchange Rule 104(e)

Some comment letters discussed the conditions under which a specialist should be allowed to provide price improvement to an incoming order. Parameters for specialist price improvement were first proposed in Amendment No. 2 and were modified by Amendment No. 5. In summary, Amendment No. 5:

(i) eliminated the requirement that the Exchange quotation spread has to be at least three cents in order for the specialist to provide systemic price improvement;

(ii) modified the requirement that the specialist must be represented in the relevant bid or offer in a specific amount (the lesser of 10,000 shares or 20% of the respective bid/offer size) to require simply that the specialist be represented in the bid if buying or the offer if selling;

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42 See Amendment No. 5 to SR-NYSE-2004-05, Exhibit 1, at 66-67.

43 NYSE OPENBOOK is a compilation of limit order data at each price that the Exchange provides to market data vendors, broker-dealers, private network providers and other entities through a data feed, and currently, includes the aggregate limit order volume outside the Exchange's best bid and offer. Currently, the Exchange updates NYSE OPENBOOK every five seconds. The Exchange has proposed to make available an enhanced NYSE OPENBOOK service that would update NYSE OPENBOOK limit order information in real-time. See Securities Exchange Act Release No. 50275 (August 26, 2004), 69 FR 53760 (Sept. 2, 2004) (SR-NYSE-2004-43). The proposed real-time service would allow subscribers to choose to either continue to receive their current service unchanged or to upgrade to the new real-time service.

(iii) eliminated the maximum size requirement for the order receiving price improvement and the requirement that the specialist fill the entire order; and

(iv) modified in certain circumstances the minimum amount of price improvement required, as follows:

(a) .02, where the quotation spread is .03-.05 (as originally proposed);

(b) .03, where the quotation spread is more than .05; and

(c) .01, where the quotation spread is .02.

Accordingly, in response to written comments regarding Amendment No. 5 by various parties, including the Investment Company Institute,[44] and continued discussions with Exchange constituents, the Exchange has proposed in Amendment No. 6[45] to require that the specialist be represented in the relevant bid or offer in a meaningful amount in order to be able to price improve an incoming order. The Exchange defines "meaningful amount" for this purpose as a minimum of 1,000 shares. However, there are securities whose average daily trading volume is such that "meaningful" representation in the bid or offer will be deemed to be something less than 1,000 shares.

Further, the Exchange clarified in Amendment No. 6 that the specialists' ability to price improve incoming orders applies only to marketable orders. The specialist may not systemically trade with an incoming order that would improve the BBO until such order has been quoted as the new best bid or offer (as described above) even if such transaction would provide price improvement to that order.

<u>Opportunities for Other Market Participants to Trade with Incoming Orders</u>

Throughout the process of formulating rules governing specialist-provided price improvement, the Exchange has sought to balance the benefit this provides to incoming customer orders with the interests of customers who have displayed orders at prices inferior (albeit by as little as one cent) to that which the specialist is willing to trade or who would like a similar opportunity to trade with incoming orders.

In response to comments that other parties should also be allowed to have the ability to

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[44] <u>See, e.g.,</u> ICI Letter III, at 2, Vanguard Letter, at 2, footnote.3;; Rutherfurd Letter I, at 11, 15; Rutherfurd Letter III, at 21-23; Bloomberg Letter at 4-5.

[45] <u>See</u> Amendment No. 6 to SR-NYSE-2005-04.

price improve or trade with incoming orders,[46] the Exchange is in the process of developing the means by which Floor brokers would have the ability to systemically provide price improvement or trade with incoming orders via a discretionary price capability.[47] In addition, as described in Amendment No. 5, the Exchange has proposed converting CAP-DI orders that are able to trade along with the specialist at the improved price, so that these orders can participate in that execution.

In addition, customers will have the opportunity to receive price improvement by entering an NYSE Auction Limit Order℠ ("AL orders") or NYSE Auction Market Order℠ ("AM order"). These orders will be exposed in the auction market, where the Crowd or specialist may offer an opportunity for execution at a better price than the Exchange bid or offer. Price improvement can also result from the order's participation in an automatic execution, sweep or specialist provided price improvement in accordance with the required parameters or possible interaction with a discretionary order.

The Exchange believes that the opportunity for price improvement is an important factor in market quality and a hallmark of the Exchange. If all orders traded at the published quote, considerable retail liquidity would be removed from the market by broker-dealer internalization at one cent better than the national best bid/offer ("NBBO"). The Hybrid Market preserves this important aspect of the Exchange's current market.

<u>Trade-throughs and Order Protection</u>

Comments were received on the consistency of the Hybrid Market proposal with the Order Protection Rule of Regulation NMS.[48] All of the hybrid filings have emphasized that it will operate in full conformity with all SEC rules, including Regulation NMS. Indeed, the Exchange cannot operate otherwise and reiterates that the Hybrid Market proposal is consistent with Regulation NMS.

In fact, in response to a specific comment submitted after Amendment No. 1,[49] that in the Hybrid Market proposal, the specialist can trade through better prices on another market

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[46] <u>See, e.g.,</u> Telic Letter, at 1; SIA Letter I, at 3; Rutherfurd Letter I, at 11, 15; ICI Letter III, at 3.

[47] A filing regarding this new capability that has been described previously as a discretionary order will be submitted shortly.

[48] <u>See</u> Securities Exchange Act Release No. 51808 (June 9, 2005), 17 CFR 200, 201, 230, 240, 242, 249, and 270.

[49] <u>See</u> Securities Exchange Act Release No. 50173 (August 10, 2004), 69 FR 50407 (August 16, 2004) (Amendment No. 1 to SR-NYSE-2004-05).

center below the NBBO,[50] the Exchange noted in Amendment No. 2[51] that:

> "Nothing in this filing or in the operation of sweeps is inconsistent with or undermines the fundamental tenet of the trade-through rules ("TTR") – that better bids and offers published by other market centers are entitled to protection. The proposals, including automatic electronic routing of orders to the market centers displaying better priced bids and offers, are consistent with the TTR. Best bids (offers) published by away markets that are better than a sweep price will be satisfied in their entirety.[52] As today, best bids and offers in these markets (i.e., "top of the book") are entitled to price protection. Intermarket price-time priority has been extensively debated,[53] but has not been viewed to be in the best interest of the national market system. In any event, Regulation NMS proposes to permit customers to sweep multiple markets contemporaneously to access better priced liquidity that may be available.
>
> The ability of the specialist to match a better-published bid or offer rather than shipping an order to that bid or offer is permitted today. The proposed rules simply speed the process by permitting the specialist to electronically match or ship. During the sweep, a commitment to trade that satisfies the full amount of any better bid or offer that is published as the best bid or offer by another market center will be auto-routed to such market (if a trade-through would otherwise occur). This is similarly consistent with the TTR."

Similarly, the Exchange also specifically addressed comments[54] that the specialist will be able avoid complying with the trade-through rule by publishing a "preemptive" 100-

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50 See, e.g., Bloomberg Letter I, at 6-7.

51 See Securities Exchange Act Release No. 50667 (November 15, 2004), 69 FR 67980 (November 22, 2004) (Amendment Nos. 2 and 3 to SR-NYSE-2004-05)- See Exhibit 1 at 39-40.

52 As per footnote no. 16 to Exhibit 1, Amendment No. 2: "This presumes that the customer does not instruct the broker "do not ship," consistent with the proposed Regulation NMS concept of an intermarket sweep. See Securities Exchange Act Release No. 49325 (Fe.b. 26, 2004), 69 FR 11126 (March 9, 2004). See also Securities Exchange Act Release No. 49749 (May 20, 2004), 69 FR 30142 (May 26, 2004)."

53 As per footnote no. 17 to Exhibit 1, Amendment No. 2: "See, e.g. SEC Concept Release on Market Fragmentation, Securities and Exchange Act Release No. 42450 (Feb. 23, 2000)."

54 See, e.g., Bloomberg Letter I, at 9-10, ex. 2 and fn. 9; Fidelity Letter I, at 4.

share bid or offer. In response to this, Amendment No. 2 to SR-NYSE-2004-05[55] responds as follows:

> "It has been suggested that the proposed rules will enable the specialist to avoid complying with the TTR by publishing what has been termed a "preemptive" 100-share bid or offer. This is erroneous. For example, the Exchange quotation is 19.91 bid, offered at 20.00, 100 x 500. There are offers on the book to sell 100 shares at 20.04, 500 shares at 20.05, 300 shares at 20.07, 100 shares at 20.08 and 1,000 shares at 20.09. Another market center also has published an offer to sell 500 shares at 20.00. An [auto ex] order to buy 2,000 shares arrives at the Exchange. 500 shares automatically execute at 20.00 on the Exchange, and 500 shares are automatically routed to the other market center as a commitment to trade at 20.00. The remaining 1,000 shares sweep the Exchange book, trading at 20.08, providing price improvement to the orders on the book. Alternatively, the specialist algorithms may determine to execute the entire order on the Exchange at 20.00. This example presumes that only one market center has a better published bid (offer) than the Exchange best bid (offer) or sweep price. All market centers that have a better published bid (offer) than the price the Exchange will trade at will be satisfied….."

Accordingly, the Exchange believes that its Hybrid Market proposal is fair and appropriate and benefits all market participants. It seeks to balance the competing interests of the various participants in the Exchange marketplace, while continuing the processes that make the New York Stock Exchange, Inc. the market of choice.

* * *

If you have any questions regarding the foregoing, please feel free to contact Nancy Reich, Vice President, Market Surveillance, at (212) 656-2475, Donald Siemer, Director, Market Surveillance, at (212) 656-6940, Jeffrey Rosenstrock, Principal Rule Counsel, at (212) 656-5499, or Robert McSweeney, Senior Vice President, Competitive Position Group, at (212) 656-6766.

Sincerely yours,

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55 See pages 40-41 of Exhibit 1 of Amendment No. 2 to SR-NYSE-2004-05. See Securities Exchange Act Release No. 50667 (November 15, 2004), 69 FR 67980 (November 22, 2004) (Amendment Nos. 2 and 3 to SR-NYSE-2004-05).