December 17, 2005

Dear SEC:

I am writing to call the Commission's attention to two comment letters, submitted under SR-NYSE-2004-05 (the NYSE's "hybrid market" proposal) that seriously call into question positions the NYSE has taken in SR-NYSE-2005-74.

In SR-NYSE-2005-74, the NYSE is seeking "immediate effectiveness" of a purported "longstanding interpretation" that would legitimise specialist parity acquisition trading. The NYSE represented that such trading is needed to accommodate the needs of major customers who wish to have specialist trading volume accompanying their own trading volume.

The "Longstanding Interpretation"

In its July 20, 2005 comment letter to the Commission, the Investment Company Institute ("ICI") stated (page 3), "Exchange rules currently prohibit special ists from trading for their proprietary account on parity with the 'crowd' where the specialist is establishing or increasing its position." By clearly emphasising the current prohibition (acknowledged by the NYSE itself in Amendment 5 to SR-NYSE-2004-05), the ICI (which represents major NYSE customers) is clearly manifesting that it has no awareness of a "longstanding interpretation" that would permit such trading.

In its December 7, 2005 comment letter, the NYSE's Independent Broker Action Committee ("IBAC") stated (page 4), "The current rules do not provide such an entitlement [to engage in parity acquisition trading], and thus limit the ability of specialists to use their information and speed advantages vis-a-vis other market participants ." The IBAC, which represents more than 100 NYSE floor brokers, is similarly manifesting a lack of awareness of any "longstanding interpretation" permitting such trading.

It 's quite simple, really: neither the NYSE's major customers, nor the brokers on the NYSE floor who represent the interests of such customers, have ever heard of the "longstanding interpretation." It's not surprising. As I have demonstrated in prior correspondence, there obviously is no "longstanding interpretation." The NYSE staff have been unable to substantiate its existence in any way, and their attempts at "linguistic explication" are so embarrassing that one wonders if anyone "higher up" at the NYSE actually reviews this material before it is submitted to the SEC.

The Need for the Proposal

The NYSE's position that specialist parity acquisition trading meets the needs of customers is emphatically rejected by both the ICI and the IBAC. The ICI observed (page 3):

"The Institute opposes eliminating the res triction [against specialist parity acquisition trading]. Placing specialists trading for their proprietary account on parity with investor orders misaligns the interests of participants on the Exchange...."

The IBAC noted that parity liquidations have long been permitted. As I have demonstrated in prior correspondence, this is because the ability to liquidate, and thereby recapitalise, has historically been deemed to be an important adjunct to the market making function, and therefore not inconsistent with the negative obligation. As I have further noted, there is no such "market making rationale" with respect to parity acquisitions, and that is why they have historically been prohibited. The IBAC notes that with respect to parity acquisitions (page 7):

"Entitling the specialists to parity when opening or increasing positions would...have the added negative consequence of increasing volatility in the market....Indeed, the specialist's role would be largely shifted from its traditional one of auction facilitator to being much more of a market competitor. The specialist's 'negative obligation' would thus be turned on its head, as specialists would be permitted to use their information and speed advantages to participate in proprietary trading to a much greater extent than they are today."

It really is this simple: notwithstanding the NYSE's self-serving representations, neither the NYSE's major customers, nor those who represent the interests of those customers on the NYSE floor, see any need at all for specialist parity acquisition trading, and in fact are strongly opposed to the practice.

Surely, the SEC staff see what is going on here. The NYSE specialist community, smarting from the huge fines it had to pay and under bottom-li ne profitability pressure, is lobbying aggressively to the credulous NYSE staff (under the cover of "price improvement" and "meeting customer needs") for increased proprietary trading opportunities, both with respect to "parity" trading and the NYSE's "algorithm" proposal. Both proposals are clearly inconsistent with the negative obligation and the historic regulatory framework governing specialist dealer activity, and are not wanted by the NYSE's customers.

An Observation on Immediate and Accelerated Effectiveness of NYSE Proposals

Based on NYSE rule submission proposals over the past year or so, I would urge the SEC staff to look very critically at anything the NYSE submits for immediate or accelerated effectiveness. The SEC staff rejected the NYSE's attempt to give immediate effectiveness to SR-NYSE-2004-70. I have demonstrated in very specific detail how the NYSE obtained immediate effectiveness of SR-NYSE-2005-57 based on a fundamental misrepresentation/error with respect to a basic rule (the NYSE has for all intents and

purposes acknowledged this error by proposing its amendment to Rule 76 in SR-NYSE-2005-87). In what was obviously a pre-negotiated "done deal", the Commission gave accelerated effectiveness to SR-NYSE-2005-87 and approved the NYSE's ability to implement (temporarily) highly controversial, substantively unapproved rules, with no prior public comment. (Obviously the SEC was under pressure here with respect to the NYSE's perceived need to test systems, but that problem is the NYSE's, not the public's).

These are not simply arcane, "technical" matters. The NYSE's proposals have direct economic consequences to public orders. The SEC staff need to err on the side of caution, and require that the NYSE submit trading floor-related proposals for prior public comment. I have demonstrated in several contexts (e.g., SR-NYSE-20 04-70, SR-NYSE-2005-57, and the NYSE's September 21, 2005 comment letter on SR-NYSE-2004-05) that the credibility of relatively inexperienced NYSE staff with respect to the representations they make about trading rules is becoming an increasingly serious issue. The SEC staff need to take that lack of credibility into account, and aggressively assert the public interest in these matters.

And that brings us to SR-NYSE-2005-74. The NYSE is again using the immediate effectiveness vehicle to effectively circumvent the prior public comment process with respect to what is, as the ICI and IBAC letters demonstrate, a highly controversial matter. There is no "longstanding interpretation" and the NYSE needs to present a formal rule amendment for prior public comment here. (And, based on comments such as those from the ICI and the IBAC, it is doubtful that the Commission could possibly find such a proposal to be in the public interest).

The NYSE should have learned from its experience with SR-NYSE-2004-70 that simply submitting a matter for immediate effectiveness does not mean, ipso facto, that the matter is approved. An SEC approval order is required, which is the manifestation to the public that the Commission is satisfied that the matter has been "properly designated" as an "interpretation" per SEC Rule 19b-4(f). Notwithstanding the failure of the NYSE to obtain the required approval order, the NYSE has issued its proposed Information Memo anyway, and (there is no other way to say it) is therefore proceeding illegally under that Memo. The situation has become absurd. In its December 13, 2005 resubmission of this matter, the NYSE noted that this is an "initial" submission. How then can the NYSE possibly be allowed to proceed as it is?

Conclusion

The SEC staff must uphold the integrity of its processes here, and requir e that the NYSE rescind the Information Memo.

The SEC staff must inform the NYSE that this matter has not been "properly designated" as an "interpretation", and must be resubmitted as a formal amendment to the text of Rule 108, under the normal prior public comment procedure.

Sincerely yours,

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