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Via email to rule-comments@sec.gov

Nancy M. Morris, Esq.
Secretary
Securities and Exchange Commission
Station Place
100 F Street, NE
Washington, DC 20549-9303

Re: SR-NYSE-2006-04 – ("Rule 116 Filing")

Dear Ms. Morris:

The New York Stock Exchange LLC (the "Exchange" or "NYSE") is writing to respond to a letter[1] submitted in response to the Securities and Exchange Commission's (the "Commission" or "SEC") solicitation of comments in connection with SR-NYSE-2006-04 ("the Filing") and Amendment Nos. 1 and 2 thereto.[2]

Many of the comments raised in the letter relate to rule changes proposed in other NYSE filings which have already been approved by the SEC, including SR-NYSE-2004-05 ("Hybrid Market")[3] and non-substantive issues. This letter responds only to substantive comments on the proposals included in SR-NYSE-2006-04 ("Rule 116 Filing").

Background

NYSE Rule 116 ("Stop" Constitutes Guarantee) generally provides for the ability of a member to "stop" stock.[4] When a specialist chooses to stop stock, paragraph .30 in the Rule's Supplementary Material governs. This provision provides three circumstances in

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1 See letter from George Rutherfurd, Consultant, dated April 24, 2006 ("Rutherfurd Letter").

2 See proposed rule filing, Securities Exchange Act Release No. 54579 (October 5, 2006), 71 FR 61524 (October 18, 2006) (SR-NYSE-2006-04).

3 See Securities Exchange Act Release No. 53539 (March 22, 2006), 71 FR 16353 (March 31, 2006) (SR-NYSE-2004-05).

4 When a specialist agrees to stop stock, he or she agrees that the order will not be executed at a price that is worse that the price at which the specialist guaranteed.

which a specialist may choose to stop stock – at the opening or reopening of trading in a stock, when a broker in the trading crowd is representing another order at the stop price or when requested to do so by another member. In the latter circumstance, the provisions of Rule 116.30 require that the quotation spread be not less than twice the minimum variation (currently one cent), or, if the quotation spread is the minimum variation, that quote conditions (i.e., an imbalance in the amount of shares bid for or offered) suggest the likelihood of price improvement, and that the order be under 2,000 shares. The rule further provides a limitation of a total of 5,000 shares for all orders a specialist chooses to stop. A specialist may seek approval of a Floor Official to override these conditions. In addition, a specialist must take specific actions to reduce the quotation spread after the stop is granted, may not reduce the size of the market following the stop and must execute orders on the book entitled to priority against the stopped stock.

Significantly, Exchange Rule 116 does not mandate that a specialist stop stock, nor is stopping stock pursuant to that rule required by the specialist's negative or affirmative obligations. A specialist has the same ability as any other Exchange member to choose to stop stock or to decline to do so. The commenter glosses over this important fact, and his letter is rife with the inaccurate suggestion that Exchange Rule 116 obligates specialists (as opposed to other Exchange members) to stop stock and thereby guarantee the order a specific price. Rather, if a specialist opts to stop stock, Rule 116 sets forth the practice that must be followed.

Given the automation of executions and the variety of systemic tools available to specialists and Floor brokers enabling them to interact with orders and provide opportunities for price improvement that were part of the Hybrid Market initiative coupled with the complex system changes necessary to effectuate the Hybrid Market, the Exchange removed the systemic support for specialists who chose to stop stock in Phase I. This step also acknowledged the infrequent usage of the "stopping stock" option by specialists. Specialists were still permitted to opt to stop stock; however, they were required to manually report all instances where an order was stopped.[5] In the subject filing, the Exchange seeks to eliminate the specialists' ability to stop stock, given the risks to specialists endemic in such manual process.

Rather than focusing on the particulars of the subject filing, the commenter uses this letter to repeat his general attack on the Exchange and the Hybrid Market. At the core of his oft-repeated objections is his misplaced belief that specialists exist solely to provide a source against which all other market participants can trade profitably. Absent from this belief is an accurate understanding of the way in which the Hybrid Market operates or the evolving nature of securities markets generally.

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[5] See Member Education Bulletin 2005-25 (December 13, 2005) from the Division of Market Surveillance.

In this letter, the commenter incorrectly asserts that the subject filing eliminates price improvement opportunities on the Exchange. The Exchange absolutely disagrees with the commenter's allegation – opportunities for price improvement on the Exchange abound. For example, the specialist continues to be able to provide price improvement to orders, both manually and electronically, through their algorithmic-based systems.[6] In addition, through the use of d-Quotes,[7] Floor brokers are able to apply discretionary instructions to their electronically-represented orders to carry out the decisions he or she makes for their customer orders. The functionality of d-Quotes enables the Floor brokers handle their customer orders in the Hybrid Market the same way customer orders are handled today in the Crowd. With these tools, the specialist and Floor broker replicate in the Hybrid Market the competition for orders, including the opportunity for price improvement, which traditionally occurred on the Floor.

Moreover, whether or not an exchange offers orders an opportunity for price improvement is a business decision of that market center, subject to competitive forces – there is no general requirement in the federal securities laws that a market must provide incoming orders with an opportunity for price improvement. Indeed, a number of market centers have chosen to operate with structures that offer no opportunity for price improvement; yet the commenter's letter wrongly suggests that Exchange specialists are generally required to do so and must be made to continue doing so. Further, importantly, while the amendment to Rule 116.30 does not prevent any other market participant from stopping stock, this fact is not acknowledged by the commenter. Member organizations may offer their customers a guarantee that a particular order will received no worse than an agreed-upon, guaranteed price, with the member firm trading for its own account, if necessary to effectuate the guarantee. This practice is known as an upstairs facilitation or an "upstairs stop." Additionally, Floor brokers continue to be able to stop stock, as provided in Rule 116.

The commenter's letter contains many inaccuracies regarding the manner in which the Hybrid Market operates. For example, he states that Exchange Rules 76, 91 and 116.30[8]

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6 See Exchange Rule 104(b)(i)(H) and 104(e). These rules were approved as part of the Hybrid Market initiative, see Hybrid Market Release, supra note 3, and became operative on October 6, 2006.

7 See Securities Exchange Act Release No. 5477(October 5, 2006), 71 FR 60208 (October 12, 2006)(SR-NYSE-2006-36).

8 Exchange Rule 76 ("Crossing" Orders), as amended (See Securities Exchange Release No. 54578 (October 5, 2006), 71 FR 60216 (October 12, 2006) (SR-NYSE-2006-82) only applies to manual transactions and requires a member to, "… publicly offer the security at a price which is higher than his or her bid by the minimum variation permitted in such security before making a transaction with himself of herself." The rule references Exchange Rule 91, in subparagraphs (b) and (c), sets forth the requirements for a member crossing orders with his or her

require specialists to stop stock.[9] However, Exchange Rules 76, 91 and auction market/auction limit orders, approved as part of the Hybrid Market,[10] relate to providing an opportunity for price improvement; Exchange Rule 116 relates to a member's choice to guarantee a price for an order. Clearly, an opportunity for price improvement and guaranteeing a price are two separate concepts. In the trading scenario, by joining the requirements of Rules 76 and 91 with the provisions of 116.30, the commenter suggests that market participants are entitled to have the specialist stop their orders and guarantee a price, when in fact Rule 116.30 gives the specialist the **"choice"** to guarantee an execution price by stopping stock.

The specialists have not, as argued by the commenter, "been relieved of their responsibility to obtain price improvement."[11] What is being removed is the specialist's ability to stop stock, a practice that Exchange data shows was rarely used[12] and the absence of which since systemic support of this practice was removed, has had no deleterious effect on the market.

The commenter also misconstrues the concepts of "stopping stock" and "missing the market."[13] On the one hand, it is true that an order stopped by the specialist is guaranteed a specified price; however, it is the specialist as contra-party to an execution at that price who bears the risk of missing the market. Given the increased speed of execution in an automated market and the "sweep" functionality,[14] a specialist who agrees to stop an order is at greater risk of having the market move past him/her while this manual transaction is performed.

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own account. The provisions of these rules work in a manual market because there is face to face interaction. There is no face to face interaction in an electronic market, because what the Crowd would have done previously they now accomplish with d-Quotes.

9 See Rutherfurd Letter at pg. 3-4.

10 See Securities Exchange Act Release No. 53539 (March 22, 2006), 71 FR 16353 (March 31, 2006) (SR-NYSE-2004-05).

11 See Rutherfurd Letter at pg. 2.

12 Specifically, in the month of August and September 2005 (prior to the elimination of the systemic support in October 2005) specialists stopped an order an average of 2 times a day, out of over 21 million orders per day.

13 See Rutherfurd Letter at pg. 2.

14 The "sweep" functionality will allow orders to automatically execute against contra side interest in the Display Book® System at and outside the Exchange best bid or offer until the order is filled.

Since automatic executions provide essentially unfettered access to the best bid and offer, with an opportunity for automated price improvement by specialists and Floor brokers, the concept of specialists stopping stock is no longer practical. In sum, the Exchange believes that these manual transactions are not conducive to efficient trading in the Hybrid Market. Therefore, filing SR-NYSE-2006-04 seeks to amend Rule 116.30 to eliminate a specialist's ability to stop stock.

Equally oversimplified is the commenter's disingenuous statement that the Exchange can easily reprogram its systems to replicate the manual procedures necessary to stop stock.[15] The decision to remove the systemic support for stopped orders was based in part on the statistical evidence that stopping stock was simply not used by the specialist and also a consideration of the difficulties inherent in maintaining this functionality amid systems that have been designed to enable increased automatic execution capabilities.

Interspersed throughout the comment letter is a general objection to the way in which the Exchange conducts its business, criticism about the specialists' use of their algorithmic trading systems and the operation of the Hybrid Market generally, all in support of the commenter's steadfast opposition to the elimination of an inefficient and underutilized manual practice, when other more effective processes have been introduced that adequately allow the opportunity for price-improved executions.

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If you have any questions regarding the foregoing, please feel free to contact Nancy Reich, Vice President, Office of the General Counsel, at (212) 656-2475, Deanna Logan, Director, Office of the General Counsel, at (212) 656-2389, and Gillian Rowe, Principal Rule Counsel, Office of the General Counsel at (212) 656-4655.

Sincerely,

Assistant Secretary
New York Stock Exchange LLC

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[15] <u>See</u> Rutherfurd Letter at pg. 2.