MEMO# 18317

December 9, 2004

DRAFT INSTITUTE LETTER ON NYSE PROPOSED RULE CHANGE RELATING TO AMENDMENTS TO "HYBRID" PROPOSAL

[18317] December 9, 2004 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 50-04 SEC RULES COMMITTEE No. 96-04 RE: DRAFT INSTITUTE LETTER ON NYSE PROPOSED RULE CHANGE RELATING TO AMENDMENTS TO “HYBRID” PROPOSAL As we previously informed you,1 the New York Stock Exchange has filed a proposed rule change with the Securities and Exchange Commission amending its “hybrid” market proposal. The proposed rule change contains additional information on the operation of the hybrid proposal as well as additional amendments to NYSE rules. The Institute has prepared a draft comment letter on the proposed rule change. The most significant aspects of the draft letter are summarized below and a copy of the draft letter is attached. Comments on the NYSE’s hybrid proposal are due to the SEC no later than December 13, 2004. If you have any comments on the draft letter, please contact the undersigned by phone at 202-371-5408 or by e-mail at aburstein@ici.org. The draft letter states that while the amendments to the hybrid proposal are a clear improvement over the original filing, certain modifications continue to be necessary to address concerns in several areas, most significantly, how the “broker agency interest file” would interact with other orders on the Exchange. In particular, the draft letter states that concerns remain about the lack of transparency of the broker agency interest file and the accompanying priority provided to a broker. Under the proposal, while orders in the broker agency interest file would not be publicly disseminated, orders in that file would be executed on parity with investors’ orders placed on the NYSE’s display book, which are required to be displayed for the full size of the orders. The draft letter therefore recommends that the Exchange provide execution priority on the same level as fully displayed investor orders only to the portion of those orders represented by floor brokers that are displayed. Those orders that are not displayed should yield to displayed interest. The draft letter also recommends that the NYSE reexamine the proposed rules governing halts to, and the resumption of, automation to ensure that they are structured in a manner to cause disruption to automation as infrequently as possible. In particular, the draft letter recommends that the NYSE examine existing market data to ensure that the parameters of 1 Memorandum to Equity Markets Advisory Committee No. 44-04 and SEC Rules Committee No. 89-04, dated November 12, 2004 [18190]. 2 the momentum-based “Liquidity Replenishment Point” are appropriate. The draft letter states that the proposed parameters for the momentum-based LRP may be too restrictive in the current market environment, especially for very liquid stocks that may reach the proposed parameters within a very short period of time. Finally, the draft letter recommends that certain information that would be provided to specialists under the hybrid proposal also be made available to investors. For example, much of the information that specialists would be privy to when

developing their proprietary algorithm would remain unavailable to investors, e.g., the aggregate amount of broker agency interest at each price level. The draft letter states that the availability of this information solely to specialists could provide them with an unfair advantage over investors in interacting with orders on the Exchange. Ari Burstein Associate Counsel Attachment (in .pdf format)
