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Office of the Corporate Secretary-Admin.

Via email and First-Class Mail

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FINRA
Notice to Members

Thomas Gira
Executive Vice President
FINRA
9509 Key West Avenue
Rockville, MD 20850-3329
Tom.Gira@finra.org

Re: Proposed FINRA Rule Regarding Front Running of Block Transactions; FINRA
Regulatory Notice 08-83 (December 2008)

Dear Tom:

This letter is intended to memorialize the views of NYSE Regulation, Inc. ("NYSE Regulation") regarding the scope of the proposal set forth in the above referenced FINRA Regulatory Notice. NYSE Regulation shares FINRA's concerns regarding front running trading activity, and the New York Stock Exchange LLC ("NYSE"), NYSE Arca, Inc. ("NYSE Arca"), and NYSE Amex LLC ("NYSE Amex") each have had longstanding rules and/or interpretations barring front running activities.¹ Moreover, NYSE Regulation agrees with FINRA's determination to broaden the scope of NASD IM-2110-3, which is FINRA's current front running rule, to (i) extend the prohibitions of the rule to include trading in the same security that is the subject of an imminent block transaction as well as to other derivative securities, and (ii) add an affirmative consent provision for certain hedging or positioning activities in relation to a customer order.

However, NYSE Regulation seeks clarification that proposed FINRA Rule 5270 is not intended to apply to trading activity conducted in compliance with certain NYSE, NYSE Arca, or NYSE Amex trading rules. In particular, when in possession of what FINRA

¹ See NYSE Information Memos 89-53 (Nov. 27, 1989), 88-9 (Apr. 13, 1988), 85-36 (Nov. 6, 1985), and 80-38 (Sept. 11, 1980); NYSE Arca Rule 11.6; Amex Rules 24, 111.03(c), and 950(d).04; and Amex Information Circulars 79-12, 80-36, 82-37, 85-115, and 90-147.

may consider to be material, non-public market information concerning an imminent block transaction, proposed FINRA Rule 5270 bars trading in related financial instruments until such time that information about the block transaction has been made publicly available or has otherwise become stale or obsolete. Under the proposed rule, information about a block transaction is considered publicly available only after it is has been disseminated via a last-sale reporting system. The proposed rule further permits certain hedging and positioning activity based on knowledge of an imminent block transaction provided that the customer has provided prior affirmative written consent.

Notwithstanding FINRA's proposed definition of when information about an imminent block transaction becomes publicly available, and thus when trading based on such information is permissible, certain equities and options trading rules permit trading based on information relating to imminent block transactions before such transactions have been reported to last-sale reporting system. These rules require certain disclosures and/or handling procedures about the imminent block transaction before trading on such information can occur, which ensures that the information traded upon is publicly available. However, such public dissemination is not necessarily via a last-sale reporting system.

For example, on the equities markets, to minimize any possible short-term price dislocation, NYSE and NYSE Amex Equities Designated Market Makers ("DMM") can publicly disseminate, via the Consolidated Tape, a gapped quote if a block-sized order imbalance exists in a particular security. The gapped quote allows time for the entry of offsetting orders, or the cancellation of orders on the side of the imbalance. The imbalance that can trigger the gap quote policy may occur when the DMM receives a sudden influx of orders on the same side of the market at the same time, or when there are one or more large-size orders and there is insufficient offsetting interest. The existence of a gapped quote alerts the trading public of a possible block-sized order for the very purpose of attracting contra-side liquidity. NYSE Regulation seeks clarification that under FINRA's proposed frontrunning rule, because the material terms of the trade that may result from the gapped quote are not yet known, the gapped quote in of itself does not constitute a non-public imminent block transaction. NYSE Regulation seeks further clarification that dissemination of information that alerts the trading public to the possibility of a block-sized order, and any resulting trades based on knowledge of a gapped quote, would not constitute a violation of FINRA's proposed Rule 5270.

The options exchanges also have rules that permit trading based on knowledge of orders, provided that required rule-based disclosures relating to those orders are met before trading occurs. For example, all options exchanges, including NYSE Arca and NYSE Amex, have rules governing anticipatory hedging.² These rules prohibit a member (or

² See, e.g., NYSE Arca Rules 6.47A and 6.49(b) and NYSE Amex Options Rules 934.3NY and 935NY.

person associated with a member), who has knowledge of all material terms and conditions of (i) an originating order and a solicited order, (ii) an order being facilitated, or (iii) orders being crossed, the execution of which are imminent, to enter, based on such knowledge, an order to buy or sell an option of the same class as any option that is the subject of the order, or an order to buy or sell the security underlying such class, or an order to buy or sell any related instrument until either (i) all the terms of the originating order and any changes in the terms and conditions of the order of which that member or associated person has knowledge are disclosed to the trading crowd or (ii) the trade can no longer reasonably be considered imminent in view of the passage of time since the order was received. In contrast to FINRA's proposed Rule 5270, these rules permit anticipatory hedging once the terms of the order are disclosed to the trading crowd, rather than requiring that information regarding completion of the block transaction has been made publicly available via a last-sale reporting system. Accordingly, NYSE Regulation recommends that FINRA should revise its proposed Rule 5270 to clarify that trading conducted pursuant to the requirements of these and comparable anticipatory hedging rules would not be violative.

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If you have any questions regarding the foregoing, please feel free to contact Claudia Crowley, Senior Vice President, NYSE Regulation, at (212) 656-4631 or Clare Saperstein, Managing Director, NYSE Regulation, at (212) 656-2355.

Sincerely yours,



cc: Marcia E. Asquith
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FINRA
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Washington, DC 20006-1506 (by first-class mail only)