



# A Hybrid Market

## JOHN THAIN'S VISION FOR ELECTRONIC TRADING WITH AUCTION MARKET BENEFITS

**I**s it possible to ensure customers all the benefits of the centralized auction market while significantly expanding access to automated trading, all in the same marketplace? For the NYSE, says CEO John Thain, the answer is a resounding yes.

This summer, the Exchange filed a proposal with the Securities & Exchange Commission (SEC) to greatly expand its electronic order execution capabilities, evolving its already integrated market model to one that offers customers the most compelling array of trading choices. Blending the best of people and technology, this total market approach, Thain says, creates a full-fledged hybrid electronic and floor-based auction market that best serves all market participants.

To accomplish this, within the next six to 12 months the Exchange will expand its NYSE Direct+® automatic-execution service, which currently accounts for 10 percent of NYSE share volume. The proposed expansion of Direct+, which lets customers choose an immediate execution at the best bid or offer with anonymity and speed, enables more types of orders to be executed, all share sizes to be traded and faster consecutive executions at multiple price points. Thain adds it retains all the benefits of the human-based agency auction: the most efficient, lowest-cost executions, the best prices and the best ability to cope with market stress. “The hybrid market model provides more order-execution choices than any other market center, along with access to the world’s deepest pool of liquidity,” says Thain, whose initiative comes less than seven months after he joined the NYSE. “Customers who want the opportunity for price improvement of the auction will still be able to access the full breadth of the book and floor liquidity. This true hybrid market,” he adds, “underscores the NYSE’s commitment to be the most competitive global equities marketplace.”

### DESCRIBE THE NYSE MARKET AND ITS EXPANSION.

The Exchange has a long tradition of serving the world’s greatest companies and investors who put their hard-earned dollars to work in

these companies. Throughout its 212-year history, the Exchange has built its reputation by providing the deepest liquidity, tightest spreads, best prices and the lowest execution costs. What we haven’t offered to a sufficient degree is transaction speed. We’re significantly upgrading our use of technology to execute securities transactions. We want to enable customers to execute more of their orders quickly and electronically with certainty and anonymity, without sacrificing the market quality that our customers have come to expect from us.

Our goal is to create a new market model — a hybrid market. It will strengthen our market’s integrity and fairness by marrying the best of electronic trading with the auction market in a way no other market can match.

### WHY IS THIS RIGHT FOR INVESTORS AND ISSUERS?

By offering investors this broad array of choices for trading, we can better accommodate trading strategies of a wider customer base.

More choice will benefit all customers, from the smallest investors to the largest institutions. This, in turn, will strengthen our ability to set the standards for market quality. And those standards — liquidity, best price, lower volatility and low execution costs — remain the foundation of a fair and honest market.

By ensuring optimal conditions of market quality, the hybrid market also addresses one of the paramount concerns of our listed companies: reducing volatility. When we surveyed the leaders of some 400 listed companies, their most important factor in choosing a trading venue was market quality. By far the most important determinant of market quality was reduced volatility. In the past two years, 51 companies have moved their listings from the Nasdaq to the NYSE. The intra-day volatility of those companies fell, on average, by 50 percent. Reduced volatility, in turn, has enabled companies to reduce their costs of capital.

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In our hybrid market, we will provide for immediate, automatic execution against the best bid and the best offer to the extent of the displayed liquidity (volume associated with the bid or offer), without any restrictions on the frequency or size of orders submitted. At the same time, we will maintain the low volatility that is a prized feature of the Exchange.

### HOW WILL THAT BE ACCOMPLISHED?

The unfilled balance, or residual, will sweep the book until the order is executed, its limit price reached, or what's called a liquidity replenishment point (LRP) is triggered. LRPs are predetermined price points at which the NYSE will briefly change to a non-automated market. LRPs moderate price volatility and maintain fair and orderly markets during electronic sweeps.

Under the plan, LRPs will be set at nickel increments, at least five cents from the best bid or offer. This means that if the best offer in a stock is \$20.10, a customer will be able to electronically sweep the book up to \$20.15 to fill a buy order. If the best offer is \$20.11, it will allow a customer's buy order to sweep up to \$20.20, if the customer chooses to do so.

### WHAT ROLE WILL FLOOR BROKERS AND SPECIALISTS PLAY IN THE HYBRID MARKET?

Floor brokers and specialists bring human judgment and the opportunity for price improvement. The human factor is particularly important at openings and closes and during times of uncertainty, when earnings surprises or outside events could disrupt the market. Floor brokers and specialists will continue to provide liquidity and make markets, interacting with the market both on the New York Stock Exchange floor and electronically.

However, at openings and closes, or when a stock trades in a volatile manner, the market in that stock will convert to an auction mode. There, the specialist will work with brokers to find liquidity and determine the right price at which the electronic trading would resume. Fully electronic markets cannot respond well to these types of events, and so prices whipsaw, and investors get hurt. Specialists and floor brokers minimize such volatility. We'll provide the technology to ensure brokers and specialists can compete and best serve customers in a fast-market environment.

### WHAT HAS BEEN THE FEEDBACK ON THE NEW SYSTEM?

The specialist community and, for the most part, the broker community have supported the hybrid-market initiative; they understand the need to ensure that we can execute incoming trades to their full extent. Floor brokers will be given that same electronic capability. So they can interact with the Floor, as they do now, or they can interact with the market electronically.

A wide range of constituents had input, including members of our Institutional Traders Advisory Committee, Pension Managers Advisory Committee, Upstairs Traders Advisory Committee and our Board of Executives. Institutional reaction has been quite positive. A few will always say it doesn't go far enough. But overall, this is a good start toward balancing our customers' desire to trade electronically

with our desire to limit volatility. We thank all for their input.

### HOW MUCH WILL ELECTRONIC TRADING INCREASE?

Today virtually all of our orders are delivered to the point of sale electronically, and about 10 percent of our total volume is executed via Direct+. That number will definitely increase. It's difficult to predict by exactly how much, because stocks trade differently depending on their liquidity characteristics. I expect the very liquid, high-volume, and low-priced stocks to trade more electronically. Ultimately, though, our customers will decide.

### WHY IS THIS CHANGE NECESSARY?

This is positive change for the Exchange. It responds to customer needs in a way that we believe maintains the NYSE's deep liquidity and provides them with the most choice for accessing that liquidity. It blends the advantages of the agency-auction process with the speed and efficiency of technology. It enhances our competitive position and our ability to provide America's 85 million investors with what they have come to expect from the New York Stock Exchange: the best prices, the lowest execution costs, and the fairest and most efficient markets — now with speed to match. We will closely monitor the effects of the changes and make appropriate adjustments based on experience.

For more information on this New York Stock Exchange initiative, visit [www.nyse.com/pdfs/hybridmarketsummary.pdf](http://www.nyse.com/pdfs/hybridmarketsummary.pdf).

