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Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: Securities and Exchange Commission Proposed Rule – Release No. 34-60684, File No. S7-21-09; Elimination of Flash Order Exception from Rule 602 of Regulation NMS

Dear Ms. Murphy:

LiquidPoint, LLC ("LiquidPoint")[1] appreciates the opportunity to comment on the referenced rule proposal by the Securities and Exchange Commission (the "Commission") concerning the proposed elimination of the so-called "flash order" exception to Rule 602 of Regulation NMS ("Reg NMS"). The Commission's stated concerns about "flash orders", and rationale for the rule proposal, bring into sharp relief the differences between trading in equity markets and trading in the listed-option markets. It is these differences that argue for separate Reg NMS treatment for "flash orders" as they are currently utilized in the listed-option markets via the so-called "step-up" or "quote refresh" functionality. Several other comment letters, in particular, those submitted by the Chicago Board Options Exchange, the International Stock Exchange ("ISE") and the Securities Industry and Financial Markets Association, address many of these

[1] LiquidPoint, a wholly owned subsidiary of BNY ConvergEx Group, LLC, specializes in providing derivatives technology and execution solutions for U.S. listed options traders, including institutional customers and other broker-dealers. LiquidPoint provides electronic direct market access to every U.S. options exchange, as well as advanced trading capabilities that include order execution, order management, order routing and optimization, quality assurance review, and a variety of reporting and books and records capabilities. ConvergEx Group is a premier provider of investment and execution technology solutions to institutional clients worldwide. We specialize in providing a full array of leading technologies and an integrated platform of performance driven, global trading capabilities supported by a culture of extraordinary client service.

issues in detail. LiquidPoint supports much of what is set forth in those letters (although perhaps the ISE's attempt at humor is somewhat misplaced in this context, even though we understand their rationale for using it).

In particular, LiquidPoint wishes to emphasize the following points:

- The difference in liquidity profile of securities trading in the equity market versus securities trading in the option market warrants the continuing permissibility of the "quote refresh" (or "step-up") functionality in the options markets;
- Allowing an option exchange to give registered market makers an opportunity to refresh their quotes increases liquidity in the option market without creating a two-tiered market that disadvantages retail or long-term investors; and
- An important motivation for adopting quote refresh functionality on option exchanges is the prohibition on locking markets, which may no longer be in the best interest of investors.

Discussion

Even among securities industry professionals, there is a tendency to conflate trading in options with trading in equities and therefore seek to treat the two marketplaces the same in terms of functionality, trading profiles and rulemaking. LiquidPoint wishes to stress that the two markets are very different in important ways.[2] As we pointed out in our comment letter[3] on the ISE's rule proposal concerning its Qualified Contingent Cross, one core principle in the options markets is the requirement to expose all orders (including customer orders that can cross against each other) on an exchange.

The exposure requirement in the options world has several implications when analyzing the appropriateness of the option market quote refresh functionality and why it is different from the equity market's "flash order". The principle, simply stated, requires all orders to be subjected to competition before execution (there are very limited exceptions). There is no guaranteed internalization of order flow. No option market participant can execute a trade, even a cross trade, without exposing the trading interest to the public market place. The exposure rules promote, indeed protect, the important principles of price discovery, transparency, competition and accountability. With mandatory exposure, options liquidity providers (registered market makers)

[2] This is not to say that the two markets do not share common aspects. Rather, we should avoid the knee-jerk reaction of thinking they are the same and therefore doing no analysis of differences that might warrant different rulemaking for each.

[3] http://www.sec.gov/comments/sr-ise-2009-35/ise200935-9.pdf

know that they will be entitled to have a chance to participate in any trade that happens on their exchange. That is to say, every trade is an auction to which all are invited.[4]

And because the liquidity providers know they will have the opportunity to see all orders that come to their exchange, they do not always refresh their quote in every series of every option in which they make a market with their absolute best bid/ask. Remember, in the equity markets there is one security associated with each issuer, while in the option markets there are potentially hundreds of securities (series of options) associated with each underlying stock. There is not always trading interest in each series. In fact, many days can pass without a trade in a particular option series, so the market makers are not constantly updating quotes in their most competitive manner on each series. There is also not much in the way of customer-driven quotes in the options market, because it has not yet developed the same level of public customer participation. Public customers are by and large takers of liquidity, not makers of liquidity.

Equally important, option market makers are constantly at risk of having their quotes hit on multiple (even all) series of options simultaneously, resulting in significant capital exposure. As part of prudent risk management, options market makers do not post their best quotes for each series they are quoting. When combined with the exposure requirement and lack of public customers providing quotes, we understand what motivates a very different quoting style in the options market in contrast to the equity market.

The liquidity providers in the options market adapted to the always-fluctuating liquidity needs of their market and its participants in part by mandating exposure of all orders and in part by utilizing a technique akin to equity "flash orders" to "awaken" potential or additional liquidity that has been dormant because of the lack of interest in one or more series of options. The quote refresh functionality is a wake-up call that is best sent only to the registered market makers (the true liquidity providers on the exchange).[5] If the Commission deprives the option exchanges of the ability to seek out trading interest, it will deprive options market customers of liquidity.

Perhaps one relevant comparison is to trading in "Pink Sheets" and OTC bulletin board stocks. Those two groups of equity securities tend to be very illiquid. The Commission recognized this fact in promulgating Reg NMS and exempted Pink Sheets and "bullies" from most of the Reg NMS requirements. You can find a representative quote for one of these stocks, maybe even a quote that is electronically disseminated. But the chances are that when you seek to trade, that

[4] LiquidPoint discusses at greater length in its comment letter about the ISE Qualified Contingent Cross rule proposal why this mandatory exposure is important to the option market, with its innumerable series of options for each underlying equity security resulting in many more illiquid securities seeking to trade.

[5] If only registered market makers are given the ability to refresh their quotes, there is no worry of the kind of two-tiered market about which the Commission expresses concerns with respect to the equity markets. Nor can the high-frequency parasites benefit from option exchange "flash orders".

quote will be stale and not a reflection of the best price in real time. You will, however, have awakened the liquidity provider (and perhaps other liquidity providers), the quote will be "firmed up" or refreshed, and your order will trade.

Another contribution factor to the existence of quote refresh functionality is the current prohibition on locking markets. The prohibition prevents orders that are marketable at another exchange from being displayed, so a liquidity provider that may be willing to trade at a better price cannot show that quote. However, when the exchange alerted the market maker to an opportunity to trade at the superior price via the quote refresh functionality, the liquidity provider can give the order better execution quality. The Commission should reconsider the need to prohibit locking markets in the option market's transparent, electronic execution environment. The Commission has sought to narrow spreads to advantage investors. Certainly, the best pricing for both buyers and sellers is a zero spread. Allowing quotes and orders to lock across competing exchanges in the current transparent, dynamic millisecond, electronically assessable environment will provide the best opportunities for investors and make the step-up functionality unnecessary.

As demonstrated, the quote refresh functionality on option exchanges stems directly from the very different quoting and trading that takes place in the options world. It is not coincidental that the equity exchanges adopted "flash orders" after becoming aware of the quote refresh or step-up functionality provided by the option exchanges.

Aside from the liquidity benefits to investors of quote refreshing, there are also cost savings. Unlike the equity markets, the option exchanges have competing fee structures that greatly impact the true price of an option transaction. Ending the ability to seek refreshed quotes would require exchanges to route away without consideration of the transaction costs. Moreover, the prohibition on locking markets has an identical result. The fees associated with maker-taker fee structures are forced upon investors when a route away is forced upon exchanges. Investors should be able to benefit from lower cost structures by having their orders executed on the exchange they have chosen.

Conclusion

The use of the "flash order" in the options market is significantly different from the equity market. The difference stems directly from the way option markets quoting and trading occurs. The option markets flash marketable orders to exchange market makers with displayed quoting responsibilities to allow for the opportunity to "quote refresh" and match or better competing quotes. This innovative response to the unnecessary and anticompetitive prohibition on locking markets provides investors with the best execution at the most competitive cost by not requiring additional routing and the associated taker fees.

Typical of option investors, the vast majority of the order flow routed by LiquidPoint takes liquidity and there is significant demand for routing algorithms to avoid unnecessary fees. These investors will be best served by preserving "flash orders" for listed option exchanges or alternately to simply allow competing exchanges to lock the displayed quotes in the transparent, electronic, millisecond trading environment.

Sincerely,

Anthony J. Saliba
Chief Executive Officer
LiquidPoint, LLC