VIA EMAIL AND FEDERAL EXPRESS

October 29, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: SEC Release No. 34-62445 – File No. S7-21-09

Dear Ms. Murphy:

NYSE Euronext, on behalf of its subsidiary options Exchanges, NYSE Arca Inc. ("NYSE Arca") and NYSE Amex LLC ("NYSE Amex"), appreciates the opportunity to further comment on the Securities and Exchange Commission ("SEC" or "Commission") proposed Elimination of Flash Order Exemption ("Proposal")[1] from Rule 602 of Regulation NMS under the Securities Exchange Act of 1934,[2] with particular attention on listed options. NYSE Euronext continues to support the Commission's Proposal to eliminate the exemption, and appreciates the opportunity to respond to (i) comments made by the Chicago Board Options Exchange ("CBOE") in a letter to the Commission (the "CBOE Letter") which were directed at NYSE Arca (and to a lesser extent NYSE Amex) and (ii) comments made by the Securities Industry and Financial Markets Association ("SIFMA") in a letter to the Commission regarding the Proposal.[3]

Our earlier comments on the Commission's Proposal focused on issues relating to the cash equities markets as well as issues directly pertaining to the listed options marketplace.[4] We

---

1 *See* Securities Exchange Act Release No. 60684 (September 18, 2009), 74 FR 48632 (September 23, 2009).

2 17 CFR 242.602.

3 *See* letter dated August 9, 2010 from William J. Brodsky, Chairman and Chief Executive Officer, CBOE, to Elizabeth M. Murphy, Secretary, SEC, available at http://www.sec.gov/comments/s7-21-09/s72109-140.pdf and letter dated August 10, 2010 from Thomas F. Price, Managing Director, Operations,Technology & BCP, SIFMA, to Elizabeth M. Murphy, Secretary, SEC, available at http://www.sec.gov/comments/s7-21-09/s72109-145.pdf

4 *See* letter dated November 23, 2009 from Janet Kissane, Senior Vice President, Legal and Corporate Secretary, NYSE Euronext. In particular, as noted in that letter, NYSE Euronext supports eliminating flash orders, but believes that the Commission's proposal to delete Rule 602(a)(1)(a) is unnecessarily broad and may result in banning long-standing and appropriate trading practices. *See also* letter dated August 9, 2010 from Janet Kissane, Senior Vice President, Legal and Corporate Secretary, NYSE Euronext.

believe the aspects of flash trading that are seen as troubling in the context of the equities markets, namely the disincentive to post limit orders, the creation of private, locked markets that are neither transparent nor fair, and the anti-competitive impact of the practice apply equally to the options marketplace. Arguments to the contrary, such as the potential for options flash order mechanisms to provide price improvement or cost savings, are misleading and must be viewed in light of all potential outcomes, both positive and negative, associated with flash order mechanisms.

The listed options market is extremely transparent and this transparency has been a key factor in its strong, consistent and continued growth. While the industry supports various market structures and trade allocation schemes, the overall framework of the options market incorporates certain long standing principles: limited guaranteed allocations for principals, exposure of customer interest before crossing, and representation of trading interest in the disseminated market to maintain priority. Continuation of flash mechanisms will move the U.S. markets away from a robust price discovery structure towards a more fragmented, European-style market characterized by off-exchange negotiation.

In the options markets, just as in the equities markets, customers' interests are harmed when a market center electronically flashes to its market participants, with no legal obligation to the order (fiduciary, agency, or otherwise), a marketable non-contingent order that did not require any type of negotiation to execute, simply to avoid trading at an away exchange that is already displaying the National Best Bid or Offer ("NBBO"). Allowing flash order mechanisms to continue in the listed options markets will harm investors by giving privileged traders unequal access to pricing information while potentially raising the costs to the rest of the marketplace, since the mechanism enables a select group to participate on a trade without first providing the most competitive quote.

In this way, flash mechanisms on exchanges work to the detriment of the quality, fairness and efficiency of the markets. Knowing that a marketable order will be flashed encourages market participants to provide less aggressive prices and instead get a preview of risk versus opportunity prior to making the decision to trade, ignore, or take advantage of the information presented by the flash (e.g., market makers potentially moving their quote on another market to avoid interacting with the routed order). For these reasons we believe that flash mechanisms are inconsistent with the Exchange Act's mandate that exchange rules be designed to promote just and equitable principles of trade and not permit unfair discrimination.[5]

Flash Should Be Disallowed Irrespective of SEC Action On Fee Caps

Some arguments in support of flash trading in the options markets state that the practice saves customers money by potentially avoiding the need to route to better priced markets that

---

[5] 15 U.S.C. 78f(b).

charge “taker” fees.[6] NYSE Euronext continues to strongly believe that, in the context of the options markets, the concepts of flash mechanisms and the fees that exchanges are able to charge, and potential caps on those fees, are completely separate and independent of each other. Commission consideration of these concepts, to the extent they are not already, should be bifurcated and analyzed irrespective of each other.

However, if the Commission is considering these two concepts as, at the very least, touching upon each other, or to a larger extent, as impacting each other directly, then simply put, and as stated in a letter to the Commission regarding a proposed rule to establish a limit on access fees that an exchange would be permitted to charge for access to its best bid and offer for listed options on its exchange “.if fee caps are imposed, the argument that a flash process is necessary to prevent customer orders from being subject to excessive fees at other market centers would be instantly rendered obsolete—by definition, none of the capped fees will be “excessive.” Therefore, if an access fee cap is imposed, a full ban on the flashing of orders should be simultaneously enacted.”[7]

Flashing Is Not Price Improvement

Some have argued, as does CBOE, that permitting flash mechanisms fosters “price improvement.” However, it is critical to recognize that a flashing mechanism differs from an automated price improvement auction in a fundamental way in the listed options markets. Most importantly, a price improvement auction guarantees a matching execution at the NBBO while attempting, and in many cases achieving, a better price for the order over the NBBO. Flashing results in only the possibility of matching the existing NBBO price, without a guarantee thereof.

This distinction is particularly troubling in those instances where, during the flash period, the NBBO actually moves against the customer’s interests. When this occurs, the customer is in no way guaranteed to receive the initial NBBO price. This outcome stands in sharp contrast to price improvement auctions where the customer is protected and guaranteed an execution stopped at a price equal to or better than the NBBO at the commencement of the auction. Flashed orders, conversely, provide participants with unequal access to valuable information, no obligation to trade, and no assurance that a marketable order will receive a fill at the NBBO price that existed when the order was received.

---

6 At the time of this letter, six of the eight option exchanges have adopted “maker/taker” pricing models in whole or in part.

7 *See* Letter dated June 18, 2010 from Janet M. Kissane, Senior Vice President, Legal and Corporate Secretary, NYSE Euronext, commenting on SEC Release No. 34-61902.

When shown in this light, and as supported by the statistics presented by CBOE,[8] flash mechanisms cannot be considered in the same category as price improvement mechanisms as a useful tool whereby investors receive better prices. In fact, we believe that flashing is more likely to result in the opposite—price *dis*-improvement as compared to the NBBO at the time a flashing exchange receives the order. Our position is supported by CBOE's data, whereby in the month of May 2010 the CBOE flash mechanism was 4 times more likely to result in price dis-improvement than price improvement.

CBOE's Data Is Inaccurate

The CBOE Letter presents data to the Commission representing the percentage of time for which CBOE is: (a) on at least one side of the NBBO; (b) on both sides of the NBBO; and (c) alone at the NBBO as well as data purportedly representing these same metrics for the NYSE Arca market. We believe that the data presented by CBOE with respect to NYSE Arca is inaccurate, misleading and distorts the true picture of the quality of each exchange's market.[9]

In response, NYSE Euronext has compiled the same metrics for NYSE Arca and CBOE. We have found that CBOE's data *understates*, by approximately 20 percentage points, the times that NYSE Arca is on at least one side of the NBBO, and the times that NYSE Arca is on both sides of the NBBO. We also believe that CBOE's data *overstates*, by more than a factor of 4, the percentage of time for which CBOE is alone at the NBBO. Our findings are included in the table below.

---

8 CBOE's data reflects that for the month of May 2010 only 0.23% of orders executed on CBOE through its flash mechanism received a price better than the NBBO, as compared to 0.31% of orders *not* executed through flash. *See* CBOE Letter at 8.

9 The discrepancy between NYSE Euronext's and CBOE's calculations may be a result of the fact that our data does not include quotes that have been mitigated in accordance with industry-wide efforts to minimize the bandwidth consumed by quotes in inactive series. Because these series very rarely trade we believe that our method is the appropriate one for purposes of this analysis and have applied it to the calculation of both NYSE Arca and CBOE data.

	% of time on at least one side of NBBO	% of time on both sides of NBBO	% time alone at NBBO
	June 2010 Data - All Penny Pilot Classes		
CBOE Stats by CBOE	91.9%	65.7%	0.651%
CBOE Stats by Arca	94.62%	65.03%	0.144%
Arca Stats by CBOE	81.1%	66.5%	0.594%
Arca Stats by Arca	99.72%	86.53%	0.477%
	June 2010 Data – Top 100 Most Active Classes		
CBOE Stats by Arca	87.44%	47.33%	0.033%
Arca States by Arca	99.68%	87.15%	0.482%

By our calculations much of CBOE's data is fundamentally flawed. Moreover, CBOE's claim that its quotes are as aggressive, let alone more aggressive, than that on NYSE Arca is inaccurate and misleading.[10] To the contrary, our data reflects that for Penny Pilot classes NYSE Arca is on both sides of the market 20% more often than CBOE and is alone at the NBBO 3 times more often than CBOE. Moreover, for the top 100 most active classes, NYSE Arca is on both sides of the market approximately 40% more than CBOE.

Additionally, according to our data more than 13% of NYSE Arca's disseminated quotes in Penny Pilot classes are alone on at least one side of the NBBO, far greater than any other options market, including CBOE, for which the same figure stands at approximately 3%. This data reflects instances where NYSE Arca is either the first exchange to better its posted price, the last to worsen its posted price, or simply the only exchange to quote at the NBBO and further refutes CBOE's claims.

Exchange	% Alone At NBBO Bid	% Alone At NBBO Ask	% Alone At NBBO Bid and Ask
ARCA	13.57%	13.02%	1.34%
BATS	2.66%	2.68%	0.01%
BOX	1.84%	1.86%	0.18%
CBOE	3.01%	2.99%	0.21%
ISE	1.34%	1.34%	0.14%
NOM	1.85%	1.68%	0.22%
AMEX	1.24%	1.18%	0.15%
PHLX	3.20%	2.71%	0.19%

CBOE's data distorts the true state of quoting on NYSE Arca in furtherance of its argument that flash order mechanisms should be permitted to exist, when in reality CBOE has highlighted exactly why flash mechanisms should be banned. NYSE Arca is on at least one side of the NBBO nearly 100% of the time and on both sides of the NBBO more than 85% of

10 *See* CBOE Letter at 9.

the time. CBOE's flash mechanism is utilized primarily during those times when CBOE is not at the NBBO (and as we understand it also when CBOE is at the NBBO but its posted quote does not have sufficient size to execute the entire order at that best price). It is precisely these times when, but for the flash mechanism, CBOE would be required to route to the away market displaying the best price, whether that market is NYSE Arca or any other market for listed options. CBOE's poaching of the order away from the better priced market, whose customer or market maker rightfully deserves the execution, acts as a direct *disincentive* to aggressively price orders and quotes, across *all* market centers. This disincentive will remain and continue to negatively impact options quoting until the practice of flashing is eliminated.

CBOE Pays Market Makers To Quote Less Aggressively

CBOE's analysis also fails to discuss the impact of rebates and payment for order flow ("PFOF") on the exchange. CBOE, like several other options exchanges (including NYSE Arca and NYSE Amex), provides monetary incentives for firms to direct options order flow to their market. CBOE assesses a 'marketing fee' to its market makers, e-DPMs and DPMs (together referred to as market makers for purposes of this discussion), ranging from $0.10 to $0.65, for executions against certain customer orders. These marketing fees are used to pay firms to send retail order flow to CBOE. CBOE waives the marketing fee for transactions in Penny Pilot classes resulting from orders executed through the Hybrid Agency Liaison ("HAL") (CBOE's flash mechanism).[11] In addition, CBOE provides its market makers with a rebate of $0.20 per contract against fees generated from transactions on the HAL in Penny Pilot classes. NYSE Euronext notes that Penny Pilot classes account for more than 350 of the most actively traded classes and represent nearly 85% of the volume in U.S. listed options.

Taken together, the execution cost for CBOE market makers when a customer order is involved is much lower through the flash mechanism than through standard matching based on marketability. One could draw a rational conclusion that CBOE market makers are provided with an incredible incentive (up to $0.45 per contract for Penny Pilot classes) to sit on the sidelines, wait for an order to be exposed, and then interact with that flashed order. This very real monetary incentive certainly influences CBOE market makers' quoting, resulting in prices that are not as aggressive as they would be absent these rebates.

More specifically, and based on the data provided in the CBOE Letter, in May 2010 nearly 85% of orders eligible to be flashed (6,617,248 total) were in fact matched via CBOE's flash mechanism. If the lowest marketing fee of $0.10 (except for the zero level for certain ETFs) is avoided by the market maker and combined with the HAL rebate of $0.20, then market makers avoided nearly $2 million in execution costs by participating in CBOE's flash mechanism. These savings nearly equal CBOE's stated cost to route orders to away exchanges.[12] In effect, because CBOE routes most customer orders to away exchanges for

---

11 *See* CBOE Rule 6.14.

12 We note that the CBOE's arithmetic appears incorrect. If CBOE's average cost to route an order away is $0.36 and it in fact routed 6,617,248 orders away in a month, then its cost is approximately $2,382,209, not $3,643,573.

free (i.e., CBOE does not charge the customer the execution fee on the away exchange) CBOE is incenting its market makers to participate in the flash mechanism so as to save CBOE money, not CBOE's customers.

NYSE Euronext believes that neither the industry, nor the investing public, is served by rewarding this type of passive behavior. Quite the contrary, we believe that investors are harmed by this erosion of the incentive for aggressive pricing and the shadow that this activity casts on the industry's tradition of transparency. Although CBOE proclaims that it has saved customers millions in execution costs they have not addressed the savings that investors never received, due to a lack of competitive quotes fueled by the ability to wait for a flash exposure. CBOE's own data clearly shows that its market makers are willing to transact at the NBBO price displayed at the away exchange, yet do not always quote at that best price, presumably because CBOE effectively *pays* them to wait for a flashed order, and then interact with it.

Flash Harms Customers At All Market Centers

CBOE continually notes the savings its customers have experienced by way of its flash mechanism. NYSE Euronext fully supports reducing costs for the investing public, not only on its own marketplaces but across the entire industry. However, regardless of the accuracy of CBOE's figure, it fails to account for the resulting harm to market participants at the away exchange, including customers, which, by way of posting the most competitively priced quote or order, earned the right to be on the opposite side of the trade that was flashed and retained on CBOE instead of being routed.

For example, over the first half of 2010 nearly 50% of all liquidity-posting volume on Arca was cleared through the Options Clearing Corporation as customer. CBOE's flash mechanism may have benefited CBOE customers, but worked to the detriment of customers on NYSE Arca, and other exchanges, which were displaying more competitively priced orders and quotes yet did not receive a fill of their order.

When an exchange's flash mechanism permits its members or participants to wait for a flashed order, that exchange is in effect taking an execution away from a market maker or customer of another that was rightfully earned through the posting of an aggressive quote or order. NYSE Euronext believes that these issues cannot be analyzed in the silo of each exchange individually. Rather, we believe that the Commission should judge the merits of flash order mechanisms broadly, taking into account the ripple effect when the market participants of one exchange are deprived of an execution at the last microsecond by another exchange's member or participant.

Flash Presents Opportunities For Abuse That Are Difficult To Surveil For

We have previously expressed our concern that flash mechanisms create the potential for a two-tiered market providing an advantaged group of participants, without any legal responsibility to the order, with valuable information that may be used to make trading decisions against the interests of other investors, including trading ahead of public customers.

When an options participant receives the flash notification, that participant has no agency responsibility to the order, yet has a unique, and perhaps unfair opportunity and ability to use this exclusive information to either trade in the underlying, adjust their option prices in anticipation of the hedge moving the underlying security, or trade with the option NBBO interest ahead of the flashed order.

CBOE believes that its flash mechanism does not create a two-tiered market and that front-running of customer orders is unlikely.[13] However, today's order audit and surveillance tools (COATS and OATS) do not capture whether or not an order was exposed to a flash mechanism. There is no way to confirm, refute or surveil for the existence of these nefarious practices. We find it troubling that front-running and/or trading ahead of flashed orders or market makers moving their quotes on other markets based upon the information received in the flash message may exist. Without the ability to confirm that such practices are not occurring, and with the clear opportunity for abuse provided by the flash mechanism, we believe that flash should be eliminated, or at the very least suspended, until the ability to surveil and track these orders is developed. Furthermore, it could be interpreted that this information, once flashed, is now public and that use of such information to make a trading decision ahead of the customer execution is therefore not a violation of securities laws.

<u>SIFMA's Comments on Flash Misstate the Issues</u>

We believe that some of the assertions and information contained in the SIFMA letter obfuscate the actual issues with flash mechanisms. SIFMA writes that "market makers at traditional exchanges are subject to *rigorous and enforceable obligations to make continuous and competitive two-sided markets*" (emphasis in the original), implying that the same obligations do not hold in "maker-taker" exchanges, of which NYSE Arca is the largest. This is highly misleading, as NYSE Arca requires market makers to continuously quote 60% of the time (and Lead Market Makers to quote 90% of the time), similar to (and in some ways more "*rigorous and enforceable"* than) the requirements on the CBOE. We also note that the NYSE Amex exchange, which is a "traditional exchange," does not have a flash mechanism and yet is still home to a substantial market making community with significant quoting obligations and increasing market maker volume. It is therefore inaccurate to argue or imply that market makers on traditional exchanges depend on flash to provide liquidity; in this context, raising the "traditional" vs. "maker-taker" exchange debate is confusing the issue.

SIFMA also writes that "a ban on flash orders would reduce the incentive of market makers on traditional exchanges to quote in size because [the flash mechanism's] alternative means of executing smaller orders at a better price would be blocked." We note that both NYSE Arca and NYSE Amex allow market makers, as well as other market participants, to place orders of different sizes at different price points simultaneously without the use of any flash mechanism. It is simply not the case that, in the absence of flash mechanisms, market makers would somehow be unable to indicate their desire to trade a smaller size order at more aggressive prices than for a larger-sized order.

---

13 *See* CBOE Letter at 13.

We also highlight that SIFMA repeatedly refers to “flash orders” in its letter. There is no such thing as a “flash order” in the options marketplace. “Flash” is not an order type, and customers do not send orders to exchanges with an explicit indication that they desire their orders be flashed. Rather, options exchanges operate flash mechanisms themselves and do not give customers a choice whether to opt in or opt out of having their orders flashed.

Conclusion

NYSE Euronext applauds the Commission’s request for additional comments on the Proposal so that use of flash mechanisms in the options industry can be further explored. We continue to believe that flash mechanisms are detrimental to the industry, independent of any other market structure issues, such as potential caps on exchange fees.

We appreciate the opportunity to provide additional comment on this important Proposal. For the reasons stated above, and in our previous letters on this matter, we urge the Commission to include the options markets within its Proposal to eliminate the flashed order exemption from Rule 602 of Regulation NMS, and any potential final approval thereof, and to proceed with eliminating flashed orders from the regulated securities markets entirely.

Very truly yours,