SIFMA
Securities Industry and Financial Markets Association

December 20, 2006

Ms. Nancy M. Morris
Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File Numbers SR-Amex-2006-106, SR-BSE-2006-48, SR-CBOE-2006-92, SR-CBOE-2006-98, SR-ISE-2006-62, SR-NYSEArca-2006-73, SR-Phlx-2006-52 and SR-Phlx-2006-53

Dear Ms. Morris:

On behalf of the Options Committee of the Securities Industry and Financial Markets Association ("SIFMA"),[1] we appreciate this opportunity to comment on the following quote mitigation proposals developed by the various options exchanges in connection with the pilot program for penny quoting in options scheduled to begin in January 2007:

- American Stock Exchange ("AMEX") Proposed Rule Change Relating to the Adoption of a Penny Quoting Pilot Program (File No. SR-Amex-2006-106, Release No. 34-54741, Nov. 9, 2006) ("AMEX Proposal");
- Boston Stock Exchange ("BSE") Proposed Rule Change to Implement a Quote Mitigation Plan (File No. SR-BSE-2006-48, Release No. 34-54779, Nov. 17, 2006) ("BSE Proposal");
- Chicago Board Options Exchange ("CBOE") Proposed Rule Change Relating to the Penny Pilot Program (File No. SR-CBOE-2006-92, Release No. 34-54805, Nov. 21, 2006) ("CBOE Proposal I");

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

- CBOE Proposed Rule Change Relating to the Adoption of a Hybrid Electronic Quoting Fee (File No. SR-CBOE-2006-98, Release No. 34-54804, Nov. 21, 2006) ("CBOE Proposal II");
- International Securities Exchange ("ISE") Proposed Rule Change to Implement a Pilot Program to Quote and to Trade Certain Options in Pennies (File No. SR-ISE-2006-62, Release No. 34-54603, Oct. 16, 2006) ("ISE Proposal");
- NYSE-Arca ("NYSE-Arca") Proposed Rule Change to Create a Penny Pilot Program for Options Trading (File No. SR-NYSEArca-2006-73, Release No. 34-54590, Oct. 12, 2006) ("NYSE-Arca Proposal");
- Philadelphia Stock Exchange ("PHLX") Proposed Rule Change, and Amendment No. 1 Thereto, Relating to Quoting Obligations (File No. SR-Phlx-2006-52, Release No. 34-54648, Sept. 12, 2006) ("PHLX Proposal I");
- PHLX Proposed Rule Change and Amendment No. 1 Thereto Relating to Assignments in Options Based on Root Symbol (File No. SR-Phlx-2006-53, Release No. 34-54807, Nov. 21, 2006) ("PHLX Proposal II")

SIFMA believes that a comprehensive approach to quotation mitigation strategies is essential, and therefore decided that a single comment letter on the quotation proposals of all exchanges would be the most effective and efficient way of transmitting its view on these important issues. As a result of the timing of the submission of the proposals, some comment periods have expired, and in one case an exchange's proposal has been approved by the Commission. SIFMA respectfully requests that the Commission consider these comments on all exchange proposals notwithstanding the expiration of some of the comment periods.

SUMMARY OF COMMENTS

SIFMA supports the Commission's desire to see effective quote mitigation strategies adopted in the options markets, and urges the Commission to work with the options exchanges toward a uniform and effective quote mitigation strategy. Of the various proposals made by the exchanges, SIFMA strongly supports the "holdback timer" proposals as the most effective proposals and the ones that will not significantly interfere with market transparency and consumer choice. By delaying the transmission of quotes by very brief intervals resulting in the "pulsing" of quotes, transient quotes that are already stale by the time the information is transmitted will be eliminated. Certain other proposed or existing practices, such as notifying members whose quote activity suggests system malfunctions or wrong settings and delisting of truly inactive series can also contribute to quote mitigation. On the other hand, SIFMA opposes certain proposals, such as failing to disseminate quotes in certain less active series, which SIFMA believes to be ineffective and/or potentially detrimental to the liquidity and transparency of the options markets.

DISCUSSION

SIFMA strongly supports the Commission's decision to solicit from each options exchange a quote mitigation proposal to address significant quotation capacity issues, particularly in light of the likely exacerbation of such issues in a penny quoting environment. The recent explosive growth of options data traffic generates two major concerns for the industry. First, quotations may exceed the capacity of the Options Prices Reporting Authority ("OPRA") to receive and process data from the exchanges. Second, growing data traffic may overwhelm the ability of data vendors to receive and process data from OPRA and to pass that data on to their subscribers. The effect of any such bottleneck in the quote distribution system may be to deprive investors and other market participants of timely and accurate market information. Therefore, it is essential that industry key participants develop a workable quote mitigation plan to adequately address these concerns as soon as possible. The exchanges have proposed various quotation strategies which include:

- limiting the options series for which quotes are disseminated;
- encouraging or forcing exchange members to limit the number of quotes that they enter into the market; and
- reducing the volume of quotes that the exchanges report to OPRA, or the volume that OPRA disseminates to market vendors, by utilizing a holdback timer or similar mechanism.

Some strategies may be carried out primarily by the exchanges and require little, if any, exchange member involvement. In comparison, other strategies may require exchange members to expend resources on matters such as upgrades of systems hardware and software and training of personnel to comply with new exchange rules. Strategies in this latter category, if implemented, will have a significant impact on exchange members' businesses. The choice and implementation of a particular quote mitigation plan is an issue of great importance to SIFMA members, and accordingly SIFMA hopes that the Commission will play an active role in guiding the exchanges to reach a uniform approach to this issue.

A UNIFORM APPROACH IS IMPORTANT TO THE SUCCESS OF A QUOTE MITIGATION PLAN

SIFMA understands that the exchanges have independently submitted proposals designed to alleviate the quotation traffic problem. The proposed strategies include:

- active monitoring of exchange members and vendors who submit significantly more quotes than others;[2]
- preventing exchange members from submitting additional quotes once they have reached certain limits;[3]

[2] See AMEX Proposal, CBOE Proposal I and ISE Proposal.

- imposing additional fees on exchange members who exceed their monthly allocations of quotes and/or bandwidth;[4]

- reducing certain exchange members' continuous quoting obligations by limiting such obligations to options series that will expire within a specified timeframe;[5]

- reducing certain exchange members' continuous quoting obligations by allowing such members to choose to be assigned to specific series instead of all series in a options class;[6]

- allowing certain members who are physically present on the exchange floor to join their quotes with quotes disseminated by specialists;[7]

- reporting data to OPRA only for actively traded options series;[8]

- delisting options whose national average daily volumes are below certain thresholds;[9] and

- employing a "holdback timer" or similar mechanism to delay the dissemination of quotation updates from the exchange to the OPRA.[10]

While SIFMA recognizes that each proposal may have some merit, SIFMA strongly believes that a lack of uniformity among plans adopted by the exchanges will result in burden on member firms and confusion for market participants, especially retail investors. This is particularly true given the already challenging situation that will exist as a result of the initiation of the penny quoting pilot in January 2007 followed by the implementation of Regulation NMS in February 2007. It is important that any quotation mitigation plan be understood by all market participants, including investors, and understanding will be impaired by the existence of multiple competing plans. Finally, uniformity is particularly important if the exchanges plan to use strategies that require a great deal of exchange member involvement or will have a significant impact on their businesses. In such case, competing plans would subject exchange members and ultimately investors to the potentially excessive costs of systems modifications and personnel training associated with the different plans. Accordingly, SIFMA believes that the exchanges should strive to implement a uniform quote mitigation plan. SIFMA urges the Commission to take an active role in this process and hopes that the Commission will review the exchanges' proposals thoroughly with help from industry

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[3] See CBOE Proposal I.

[4] See CBOE Proposal I, CBOE Proposal II and ISE Proposal.

[5] See CBOE Proposal I and PHLX Proposal I.

[6] See PHLX Proposal II.

[7] See AMEX Proposal.

[8] See NYSE-Arca Proposal.

[9] See AMEX Proposal, CBOE Proposal I and ISE Proposal.

[10] See AMEX Proposal, BSE Proposal and ISE Proposal.

representatives and OPRA to determine the optimal strategy. If the development of a uniform plan cannot be achieved, at a minimum the features of the plans of various exchanges should be as similar as possible to reduce the burden on member firms.

In the event that the exchanges employ significantly different quote mitigation plans, SIFMA believes that the Commission should closely monitor each plan. Certain plans may have an obvious adverse effect on customers and the options markets, and in this situation the Commission may need to quickly mandate adjustments to such plans and thereby limit harm to investors. Similarly, the Commission may wish to require exchanges to adopt strategies that are found to effectively reduce quotation traffic without significant adverse impact.

THE "HOLDBACK TIMER" OR A SIMILAR STRATEGY IS THE MOST EFFICIENT MEANS OF REDUCING QUOTATION TRAFFIC

Three exchanges have proposed strategies that involve utilizing a "holdback timer" or similar mechanism to reduce the amount of options data transmitted from one node to the next in the data dissemination chain, as well as to reduce the frequency of transmission.[11] The basic concept is that, under certain circumstances, the exchange will report options data to OPRA at very short intervals, typically a few hundred milliseconds, rather than continuously. AMEX and ISE already have holdback timers in place and were seeking to codify their practices through their rule filings. BSE proposed a similar system that it labeled as "bundling" of quotes. Some market participants refer to such strategies as "pulsing" of quotes. Because only the most recently received quotes are transmitted, pulsing reduces data traffic by eliminating very transient changes in quotes and therefore reduces the quote "flicker" problem. The holdback timer strategy has the advantages of reducing the overall amount of data traffic while not interfering with exchange members' ability to submit quotes to the market. Because the contemplated delays in data transmission are very brief, transparency of the market would be preserved and there should be no disadvantage to either market professionals or investors.

SIFMA believes that the use of holdback timers is the most effective means of quote mitigation and should be considered by the exchanges that have not already adopted this approach. SIFMA urges the Commission to encourage and coordinate the exchanges toward that end. If the task of developing a quote mitigation plan falls on OPRA, SIFMA suggests that OPRA should take the same approach by switching from providing continuous data feeds to vendors to "pulsing" data feeds to vendors at intervals of 250 or 500 milliseconds, for example. In all cases, the precise formulation of triggering conditions and delay intervals should be determined from empirical/trial data to ensure that the market place is made more efficient without greatly reducing its transparency.

[11] See AMEX Proposal, BSE Proposal and ISE Proposal.

Other Strategies Proposed By The Exchanges Are Less Effective Or Difficult To Implement And In Some Cases May Be Harmful

In comparison to the holdback timer and similar strategies, SIFMA believes that some strategies proposed by the exchanges, while they may be appropriate and make some contribution to quote mitigation, will be less effective or difficult to implement. Other strategies will actually prove harmful and should be rejected.

Some exchanges have proposed a "quotation fee," *i.e.*, a fee based on the number of quotes submitted or the "bandwidth" used by an exchange member. Some market participants have referred to this strategy as "renting bandwidth" or as a "quote tax." While this approach has the appeal of being a market-based solution that minimizes coercion, SIFMA believes that it will be difficult to determine the ideal tax levels that would make this strategy effective. If the levels are set too low, quotation taxes will be largely ineffective because large market-makers will likely choose to bear the additional cost rather than cut back on their submission of quotes and risk losing their competitive image. On the other hand, if the levels are set too high, quotation taxes may discourage market-makers from efficient quoting activities. Exchange rules appropriately impose obligations on market makers to quote actively and stand ready to buy or sell whenever needed. SIFMA believes that, in order for quotation taxes to be effective, the exchanges will need to carefully structure their taxes so that the taxes (i) only penalize exchange members who quote inefficiently, and (ii) are not viewed as an additional source of revenue for the exchanges. SIFMA strongly believes that the holdback timer approach is both a more effective means of quote mitigation and one which does not have the deleterious effect of potentially discouraging active market-making. While a quotation tax could be used in conjunction with a holdback timer arrangement, it may prove difficult to set the tax at the correct level.

SIFMA opposes strategies that would significantly limit market transparency. Because users of options products generate trading ideas from quote data, reducing market transparency could limit the options industry's growth. In addition, reducing transparency would effectively reduce investment opportunities for investors who consistently rely on options to limit risk and enhance returns. Therefore, SIFMA objects to NYSE-Arca's proposal of simply not disseminating quotations at all—sometimes referred to as "going dark"—in some less active series. If a series is not sufficiently inactive to be delisted (see below) and quotations are indeed being submitted to an exchange, the exchange should make quotations in that series available to all investors. To do otherwise would create inefficiency and would generate distrust among investors who realize that trades are being executed based upon quotations that were not made available to them.

Certain existing and proposed quotation mitigation strategies are acceptable but simply not sufficient in themselves solve the problem. For example, Chicago Board Options Exchange Rule 6.23A places an upper limit on the amount of quotes an exchange member can submit in a given period of time. The Rule does not, however, discourage the exchange member from inefficient behavior as long as it has not reached the preset quotation limit. We are not aware of any specific objections that members have expressed concerning either Rule 6.23A or its implementation in practice, but we also note that it has not appeared to have a substantial impact on total quote volume. To cite another example, there is clearly nothing wrong with an exchange “monitoring” the quote volume produced by members and drawing the member’s attention to what appears to be excessive quoting that could represent malfunctioning systems or improper settings in their systems. Again, however, the quote reduction that takes place from this procedure alone is insufficient to deal with the problem.

Finally, it is existing practice of the exchanges to delist inactive options series and most SIFMA members support delisting of truly inactive series. Nevertheless, SIFMA believes that it may not necessarily be appropriate to accomplish quote mitigation by raising the standards used to decide whether an options series is “active” where raising such standards would meaningfully reduce investor choice.

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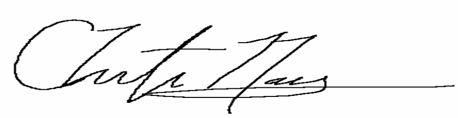
SIFMA appreciates the opportunity to submit these comments on the various quotation mitigation proposals and wishes to reiterate its strong support for the development of a uniform quote mitigation plan among the options exchanges and the use of holdback timers or similar mechanism as the preferred quote mitigation strategy. If you would like to discuss the above issues in further detail or have any question about the comments presented in this letter, please do not hesitate to contact me at (402) 970-5656, or Melissa MacGregor, SIFMA staff advisor to the Options Committee, at (202) 216-2034.

Very truly yours,



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