sifma
Invested in America

September 26, 2012

<u>Via Electronic Mail (rule-comments@sec.gov)</u>

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

Re: <u>File No. SR-BYX-2012-019: Notice of Filing of Proposed Rule Change to Adopt a Retail Price Improvement Program (Securities Exchange Act Release No. 34-67734)</u>

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to respond to the request for comment by the U.S. Securities and Exchange Commission ("SEC" or "Commission") on the above-referenced proposed rule change filed by BATS Y-Exchange, Inc. (the "Exchange" or "BYX") under Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act") to adopt a retail price improvement program ("RPI Program").[2] SIFMA members firms represent the majority of retail order flow executed in the United States today.

I. <u>Executive Summary</u>

As BYX acknowledges in its proposed rule change, the Exchange's RPI Program would raise substantially identical policy considerations as the retail liquidity programs of the New York Stock Exchange LLC ("NYSE") and NYSE Amex LLC, now known as "NYSE MKT" (together the "NYSE Program") which were recently approved by delegated authority of the Commission to its staff.[3] SIFMA notes that in connection with the NYSE Program, BATS

---

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] *See* Securities Exchange Act Release No. 67734 (August 27, 2012), 77 FR 53242 (August 31, 2012).

[3] *See* Securities Exchange Act Release No. 67347 (July 3, 2012), 77 FR 40673 (July 10, 2012) ("NYSE Program Approval Order").

Global Markets, Inc. ("BATS") expressed market structure concerns similar to those of SIFMA, yet stated that if the NYSE Program received Commission approval then BATS would likely be compelled to propose a similar program to remain competitive.[4] Now that the NYSE Program has Commission approval, SIFMA believes that BYX is just the first of several other exchanges that will propose a similar type of trading platform.

SIFMA believes that the proposed RPI Program raises many of the same important issues of equity market structure that SIFMA described to the Commission during the consideration of the NYSE Program,[5] in particular, the issues related to fair access, sub-penny quoting, and the dissemination of quotes.[6] In addition, SIFMA notes that the NYSE Program received approval only for a one-year pilot period. In this context, SIFMA is reiterating its previous concerns to keep them on the public record as the Commission considers the BYX proposal and, ultimately, whether to grant permanent approval to the NYSE Program. SIFMA respectfully requests that the Commission continue to consider these important issues in determining whether it should approve or disapprove the BYX's RPI Program and in determining whether it should or should not extend the approval of the NYSE Program beyond the one-year pilot period.

In addition, SIFMA has concerns about the Commission's increasing use of proposed rule changes by national securities exchanges to effect significant changes in equity market structure, for example the Limit Up/Limit Down plan, the amendments to the Market Wide Circuit Breakers, and the Single Stock Circuit Breakers.[7] In our view, the Commission should consider and resolve these market structure issues through its formal rulemaking process, where the Commission would have the opportunity to address and analyze in more detail the costs and benefits of these impacts to the markets. We also believe that significant changes to market structure should be approved by the Commission itself, rather than by the Commission staff acting pursuant to delegated authority; certainly, the BYX proposal is at such a high level of importance that it should be approved by the Commission itself.

---

4 *See* Letter from Eric J. Swanson, Secretary, BATS Global Markets, Inc. to Elizabeth M. Murphy, Secretary, Commission dated December 6, 2011.

5 *See* Letters from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA to Elizabeth M. Murphy, Secretary, Commission dated December 7, 2011 and March 23, 2012. In this regard, SIFMA does not agree with the conclusion in the NYSE Program Approval Order that the NYSE Program would not cause a "major shift in market structure." 77 FR at 40680.

6 *Id.*

7 *See* Exchange Act Rel. No. 62251 (June 10, 2010), 75 FR 34183 (June 16, 2010)("Approval Order of Single Stock Circuit Breakers"); 62883 (Sept. 10, 2010); *see also* Exchange Act Rel. No. 67090 (May 31, 2012), 77 FR 33531 (June 6, 2012) ("Order Approving the Modification of the Market-wide Circuit Breakers"); *see also* Exchange Act Rel. No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012)("Order Approving Limit Up-Limit Down Plan on a Pilot Basis")

II. Concerns with the BYX Proposal

SIFMA's concerns with BYX's RPI Program fall within several categories:

- The BYX proposal would extend the two-tiered market structure that began with the Commission's approval of the NYSE Program. This structure continues to raise issues of fair access when the trading interest on an exchange is made available exclusively to the orders of certain types of customers.

- The BYX proposal, like the NYSE Program, would effectively permit the Exchange to display, accept, and rank orders in sub-penny increments. If approved, this additional departure from Rule 612 of Regulation NMS would raise significant questions as to whether the benefits of sub-penny quoting justify granting another exemption from the rule to a specific market participant.

- SIFMA believes the "Retail Liquidity Identifier" that BYX would disseminate is a "quotation" for purposes of the Exchange Act and the rules thereunder. In addition, including such an identifier in the public quote stream would raise issues as to member firms' obligations to evaluate the information contained in those identifiers.

A. The RPI Program would Perpetuate a Two-Tiered Market Structure

Under the RPI Program, BYX would disseminate a Retail Liquidity Identifier when RPI interest is available that is priced at least $0.001 better than the Exchange's protected best bid or protected offer for a particular security. However, even though the Retail Liquidity Identifier would be publicly disseminated, market participants would be unable to access the quote unless they can attest that the request is to fill an order for a retail customer. This necessarily precludes institutional investors, many of which invest on behalf of retail investors. Therefore, the proposed RPI Program is inconsistent with the requirements of Section 6(b)(5) of the Exchange Act as it would allow for unfair discrimination between market participants.

SIFMA also is concerned that Commission approval of the NYSE Program, and now potentially the RPI Program, sets a precedent for other exchanges to discriminate among members. Although many exchanges currently differentiate among members in their pricing (*e.g.,* with trading fees frequently based on volume tiers or coupled with obligations to provide liquidity), other than the NYSE Program and the NYSE designated marker maker program, no other equities exchange currently discriminates on access to quotations or other trading interest based on the type of customer that wants to access the quote or interest. If the Commission has made a determination that exchanges are permitted to differentiate their access based on customer segment, then SIFMA firms request that the Commission provide guidance regarding the type and extent of discrimination that exchanges may engage in.

B. Sub-Penny Quoting should be addressed through Commission Rulemaking

As we have stated previously on several occasions,[8] including our recent comment letters on the NYSE Program,[9] SIFMA member firms continue to be concerned that quoting in sub-penny increments does not contribute to the maintenance of orderly markets and that it encourages market participants to "step ahead" of competing limit orders with economically insignificant price enhancement. Notably, the SEC has also highlighted these and other potential negative consequences of sub-penny quoting, including decreased market depth (*i.e.*, the number of shares available at a given price) and increased incidence of "flickering" quotes that make it more difficult for broker-dealers to meet best execution and other regulatory requirements to identify the best bid or offer at a particular moment (such as the "Manning" rule[10] and the short sale rule[11]).

As with the NYSE Program, the proposed RPI Program would give priority based on sub-penny increments, and tick size would be reduced to $.001 even though Rule 612 of Regulation NMS prohibits national securities exchanges from accepting or ranking certain orders based on an increment smaller than the minimum pricing increment. We note that the Commission granted an exemption from Rule 612 for the NYSE Program, and that BYX has requested similar relief in connection with the RPI Program. SIFMA believes that if the Commission has determined that the protections of Rule 612 are no longer necessary, the Commission should address that change in policy through formal rulemaking rather than through individual exemptions for specific market participants.

C. The BYX Proposal Raises Issues around the Dissemination of Quotes

As noted above, the proposed rule change provides that BYX would disseminate a Retail Liquidity Identifier when RPI interest priced at least $0.001 better than the Exchange's protected bid or protected offer for a particular security is available. The Retail Liquidity Identifier would be disseminated through consolidated data streams and proprietary data feeds of the Exchange. As we noted in commenting on the NYSE Program, we believe that this type identifier amounts to dissemination of an indication of interest that is a quote.[12] NYSE and NYSE MKT received no-action relief with respect to the application of Rule 602 of Regulation NMS to the indicator disseminated through the NYSE Program. In addition, the approval order for the NYSE Program

---

8 *See* Letter from Donald D. Kittell, Executive Vice President, Securities Industry Association ("SIA") (n/k/a SIFMA) to Jonathan G. Katz, Secretary, Commission dated November 21, 2001; s*ee also* Letter from Marc E. Lackritz, President, SIA to Jonathan G. Katz, Secretary, Commission dated June 30, 2004; *see also* Letter from Marc E. Lackritz, President, SIA to Jonathan G. Katz, Secretary, Commission dated February 1, 2005; *see also* Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA to Elizabeth M. Murphy, Secretary, Commission dated June 25, 2010.

9 *See supra* note 5.

10 *See* FINRA Rule 5320 (prohibiting broker-dealers from trading in front of customer orders).

11 *See* Exchange Act Release Nos. 49325 (Feb. 26, 2004), 69 FR 11126 (Mar. 9, 2004) ("Regulation NMS Proposing Release"); 50870 (Dec. 16, 2004), 69 FR 77424 (Dec. 27, 2004).

12 *See supra* note 5.

states that it was not necessary to determine whether the Retail Liquidity identifier was a quote for purposes of Rule 610.[13] Given that the BYX proposal is expected to be just one of several that will leverage the features of the NYSE Program, SIFMA believes the Commission should conduct an analysis of whether these identifiers are quotations and include that analysis in its consideration of the RPI Program.

Regardless of the legal status of the identifiers, the potential distribution of and access to the identifiers through the public quote stream continues to raise concerns for firms about the need to evaluate that information in meeting their regulatory obligations. A proliferation of these types of identifiers would increase compliance burdens for SIFMA's members if they are required to continuously consider and evaluate these identifiers at multiple exchanges regardless of the amount of volume traded on the various retail liquidity platforms. Using best execution as an example, it is unclear whether broker-dealers would be required to consider the Retail Liquidity Identifier in making routing decisions. As another example, the order protection rule of Regulation NMS requires firms to access the best-priced protected quotes, and the lack of clarity from the Commission in terms of whether the exchanges' retail liquidity identifiers are quotes creates uncertainty among broker-dealers regarding their order protection rule obligations.

* * *

SIFMA greatly appreciates the Commission's consideration of the issues raised above in connection with the BYX RPI Program rule filing. SIFMA would be pleased to discuss these comments in greater detail with the Commission and the Staff. If you have any questions, please call me at 202-962-7383 or tlazo@sifma.org.

Sincerely,

Theodore R. Lazo
Managing Director and
Associate General Counsel

cc: Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
Daniel J. Gallagher, Commissioner
Robert W. Cook, Director, Division of Trading and Markets

[13] 77 FR 40679, n. 70.