



March 23, 2012

Via Electronic Mail (rule-comments@sec.gov)

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

Re: Securities Exchange Act Release No. 34-66346 (File No. SR-NYSE-2011-55 and File No. SR-NYSEAmex-2011-84); Order Instituting Proceedings to Determine Whether to Disapprove Proposed Rule Changes, as Modified by Amendments No. 1 and 2, Adopting NYSE Rule 107C to Establish a Retail Liquidity Program for NYSE-Listed Securities and NYSE Amex Rule 107C to Establish a Retail Liquidity Program for NYSE Amex Equities Traded Securities

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 Commission’s order instituting proceedings under Section 19(b)(2)(B) of the Securities Exchange Act of 1934, as amended (“Exchange Act”), to determine whether to disapprove the proposed rule changes related to the New York Stock Exchange LLC (“NYSE”) and NYSE Amex LLC (“NYSE Amex” and together with NYSE, the “Exchanges”) proposed Retail Liquidity Program (“Program”),² as well as the request for comment by the Commission relating to Partial Amendment No. 2 to the proposed rule changes.³

¹ 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. For more information, visit www.sifma.org.

² See Exchange Act Release No. 66346 (Feb. 7, 2012), 77 FR 7628 (Feb. 13 2012) (the “SEC Order”).

³ See Exchange Act Release No. 66464 (Feb. 24, 2012), 77 FR 12629 (Mar. 1, 2012) (“Amendment 2”).

I. Introduction and Executive Summary

The Program's stated objective is to attract additional retail order flow to the NYSE for NYSE-listed securities and to the NYSE Amex for NYSE Amex-listed securities while also providing price improvement through sub-penny pricing. The Program would create two new classes of market participants: Retail Member Organizations ("RMO") and Retail Liquidity Providers ("RLP").

As more fully discussed herein, SIFMA believes that the Program is inconsistent with certain provisions of the Exchange Act and the Commission should therefore disapprove the Exchanges' proposed rule changes. In that regard, the Program and related request for an exemption from the prohibitions against sub-penny accepting and ranking under Regulation NMS raise significant market structure concerns that the Commission itself has raised in recent releases, namely:

- When are indications of interest subject to the Quote Rule?
- Whether sub-penny quoting benefits investors and the markets?
- Whether latencies between proprietary data feeds and the consolidated tape unfairly disadvantage certain market participants?
- Fair access issues and whether to allow two-tiered markets, where the orders of some investors have execution priority over those of other investors?

In addition, the Program also implicates issues concerning: (i) firms' best execution and Order Protection Rule ("OPR") obligations, and (ii) the potential interplay of sub-penny quoting and venues' access fees/rebates, which is complex and should be fully considered.⁴ Further, it is not even clear that "true" retail orders will benefit from the Exchanges' proposals.⁵ While SIFMA supports and encourages the exchanges to provide innovative products to investors, given these outstanding issues, we do not believe that the Commission can conclude that the Program, as presently contemplated, is consistent with the Exchange Act. The Commission should, therefore, disapprove the Exchanges' rule proposals.

II. The Program Does Not Meet the Standards for Approval Under the Exchange Act

In order to approve the Exchanges' proposed rule changes, pursuant to Section 19(b)(2) of the Exchange Act, the Commission must make a finding that the proposed rule changes are consistent with the Exchange Act and the rules and regulations thereunder. In the SEC Order,

⁴ There has been a lengthy, unresolved debate over the years on the merits of including access fees in quotes, something that is not feasible without sub-penny quoting. For instance, sub-penny quoting could enable spreads of less than the access fee, which could create gaming opportunities.

⁵ We note that retail market orders currently receive significant price improvement in certain venues, and retail resting limit orders will run the risk of being traded ahead of for a sub-penny increment.

pursuant to Section 19(b)(2) of the Exchange Act, the Commission provided notice of the grounds for disapproval under consideration, stating as follows:

“In particular, Section 6(b)(5) of the [Exchange] Act requires that the rules of an exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. In addition, Section 6(b)(5) prohibits the rules of an Exchange from being designed to permit unfair discrimination between customers, issuers, brokers, or dealers.”

As described in more detail herein, SIFMA believes that because of the significant market structure issues and concerns the Program raises, including, but not limited to, issues and concerns relating to sub-penny quoting and fair access, the proposed rule changes related to the Program would not meet the criteria required by Section 6(b)(5). In addition, SIFMA believes that the proposed rule changes are inconsistent with the requirements of Regulation NMS. The Commission, therefore, should not approve the Exchanges’ proposed rule changes.

III. The Program Implicates Pending Market Structure Issues and Concerns

A. The Exchanges Will Disseminate Quotes Through the Program

The Exchanges have generally taken the position that they will not be displaying a quote in connection with the Program and that, as a result, certain market structure issues are not implicated, including, among others, concerns regarding sub-penny quoting, stepping ahead, fair access and access fees.⁶ According to the Exchanges, in general, because the Retail Liquidity Identifier (“RLI”) would not be priced and the Retail Price Improvement Orders (“RPI”) would not be displayed, the Program would limit its sub-penny activity to sub-penny executions, and not include sub-penny quotes.⁷

As explained in SIFMA’s first comment letter on the Exchanges’ rule proposals,⁸ SIFMA believes that, given the context in which RLIs are transmitted under the Program, the Exchanges are in fact disseminating a quote and the Exchanges’ arguments on this point are not persuasive. In that regard, in the SEC Order, the Commission recognized that the RLI could be deemed to fall within the definition of “bid” or “offer” and thus be subject to the Regulation NMS’ Quote

⁶ See Letter from Janet McGinness, Senior Vice President – Legal & Corporate Secretary, NYSE Euronext to Elizabeth M. Murphy, Secretary, Commission dated January 3, 2012 (“NYSE Response Letter”).

⁷ The Exchanges state the following in the NYSE Response Letter: “The Retail Liquidity Identifier (“RLI”) does not contain a price and therefore is not a “bid or offer” and consequently not a quotation as defined by Rule 600(b)(62). Additionally, an RPI would not fall within the definition of a quotation since the order is not “communicated” to any broker or dealer, or any customer; the RPI is simply a flag reflecting non-displayed interest that is available in the exchange systems to interact with incoming Retail Orders.”

⁸ See Letter from Ann L. Vlcek, Managing Director and Associate General Counsel, SIFMA to Elizabeth M. Murphy, Secretary, Commission dated December 7, 2011.

Rule.⁹ On this point, in Amendment 2, the Exchanges amended the definition of the term “Retail Liquidity Identifier” to add that the identifier shall reflect the symbol for the particular security and the side (buy or sell) of the RPI interest but shall not include the price or size of the RPI interest.

Even with such an amendment to the definition, SIFMA believes that the Exchanges are in fact disseminating what essentially is a quote to indicate that they have resting liquidity priced at a sub-penny increment better than the current best bid or offer. Specifically, the Exchanges are disseminating a “flag” that would indicate that there are at least 100 shares priced better than the NBBO and this has the same effect as disseminating a quote. To that end, a sub-penny price can be inferred. SIFMA, therefore, believes that the Exchanges’ position that that they are not providing a quote is not persuasive as the Exchanges are essentially transmitting an actionable indication of interest (“IOI”), which under these circumstances is a *de facto* quote.

The Commission has observed that actionable IOIs are functionally quite similar to displayed quotations.¹⁰ In the Dark Pools Release, which is currently pending before the Commission, the Commission indicated that, in some circumstances, although IOIs may not specify the price or size, the practical context in which they are transmitted effectively alerts the recipient to certain information, including the price, specifically stating as follows:

“Although these IOIs may not explicitly specify the price and size of available trading interest at the dark pool, the practical context in which they are transmitted renders them “actionable” – that is, the messages effectively alert the recipient that the dark pool currently has trading interest in a particular symbol, side (buy or sell), size (minimum of a round lot of trading interest), and price (equal to or better than the national best bid for buying interest and the national best offer for selling interest).”

The Commission further stated in the same release that it “preliminarily believes that the quoting requirements of Rule 602 and Regulation ATS should clearly cover actionable IOIs.”

SIFMA believes that, given the context in which RLIs are transmitted under the Program and consistent with the SEC’s statements regarding actionable IOIs noted above, the Exchanges

⁹ Specifically, the SEC states: “In addition, the proposals do not describe with precision the attributes of the Retail Liquidity Identifier that would be disseminated when a Retail Price Improvement Order exists. Depending on those details, the Retail Liquidity Identifier could fall within the definition of “bid or offer” in Rule 600(b)(8) of Regulation NMS, which would implicate Rule 602 of Regulation NMS, also known as the Quote Rule. Rule 602 generally requires that a national securities exchange collect, process, and make available to vendors the best bid, the best offer, and aggregate quotation sizes for each NMS security traded on the exchange. Accordingly, the Commission believes the Exchanges should provide additional detail regarding the proposed Retail Liquidity Identifier, to allow the Commission and commenters to assess whether the Quote Rule is implicated and, if so, to understand whether the Exchanges intend to comply with or seek an exemption from some or all of its requirements.”

¹⁰ See Exchange Act Release No. 60997 (Nov. 13, 2009), 74 FR 61208 (Nov. 23, 2009) (“Dark Pools Release”).

are in fact disseminating actionable IOIs, which under these circumstances are de facto quotes. Furthermore, because the SEC presented the issue of whether and when IOIs are quotes, the appropriate next step would be for the Commission to provide clarity with respect to this issue through Commission rulemaking.

B. Sub-Penny Quoting Should be Addressed Through Commission Rulemaking

As specifically noted by the Commission in the SEC Order, the rule proposals related to the Program are inconsistent with the Sub-Penny Rule, Rule 612 of Regulation NMS, as, among other things, the Program ranks orders and gives priority based on sub-penny increments. Rule 612 prohibits national securities exchanges from accepting or ranking certain orders based on an increment smaller than the minimum pricing increment. The Exchanges have recognized this, and therefore filed a request for relief pursuant to Rule 612(c) of Regulation NMS.¹¹

Under the Exchanges' proposals, the Rule 612 tick size would be reduced to \$.001. If the SEC were to approve the Exchanges' proposals, the SEC would essentially be opening the door for other exchanges to establish similar programs. In that regard, SIFMA understands that a number of exchanges are contemplating filing rule proposals to establish programs similar to the Program and, therefore, the issues related to the Program are not isolated to the Exchanges. Specifically, we understand that certain exchanges have reached out to SIFMA member firms to discuss their respective versions of programs similar to the Program. Thus, what the Exchanges promote as a discrete pilot would, in reality, bring about a fundamental change in market structure.

Providing an exemption for sub-penny quoting would be a profound market structure change that has been strongly debated since at least the early 2000s. Due to the potentially significant impacts to the market, it would not be appropriate to allow sub-penny quoting via the granting of an exchange rule filing and exemptive relief; instead, decisions related to the minimum quotation increment should only be made after a thorough SEC notice and comment rulemaking process. Notably, the SEC in the past has highlighted on repeat occasions the potential negative consequences of sub-penny quoting. For example, in the SEC's 2004 release proposing Regulation NMS,¹² the SEC stated the following, among other things, with respect to sub-penny quoting:

“At the same time, the Commission believes that including those sub-penny quotes in the best publicly disseminated prices could harm investors and the markets. Among other things, and as described in more detail below, sub-penny quoting is likely to decrease further market depth (*i.e.*, the number of shares of a security that is available at any given price), increase the incidence of market participants stepping ahead of standing limit orders for an economically

¹¹ See Letter from Janet M. McGinness, Senior Vice President – Legal & Corporate Secretary, Office of the General Counsel, NYSE Euronext to Elizabeth M. Murphy, Secretary, Commission dated October 19, 2011.

¹² See Exchange Act Release No. 49325 (Feb. 26, 2004), 69 FR 11126 (Mar. 9, 2004) (“Regulation NMS Proposing Release”).

insignificant amount, and make it more difficult for broker-dealers to meet certain of their regulatory obligations by increasing the incidence of so-called ‘flickering’ quotes.”

After considering the comments received on the Regulation NMS Proposing Release, in the SEC’s 2004 release reproposing Regulation NMS,¹³ the SEC stated the following, among other things, with respect to sub-penny quoting:

“In summary, the comments received have reinforced the Commission’s preliminary view that there are substantial drawbacks to allowing sub-penny quoting, and the Commission believes that a uniform rule prohibiting sub-penny quoting (except for quotations less than \$1.00) is appropriate in this case. Sub-penny quoting generally impedes transparency by reducing market depth at the NBBO and increasing quote flickering. In an environment where the NBBO can change very quickly, broker-dealers will have more difficulty in carrying out their duties of best execution and complying with other regulatory requirements that require them to identify the best bid or offer available at a particular moment (such as the Manning rule and the short sale rule).”

As more fully discussed in several previous SIFMA comment letters,¹⁴ including SIFMA’s recent comment letter on the SEC’s concept release on equity market structure,¹⁵ SIFMA member firms continue to have concerns that quoting in sub-penny increments would not contribute to the maintenance of orderly markets. In addition, as explained in detail in SIFMA’s comment letter on the Market Structure Concept Release, sub-penny pricing could encourage market participants to “step ahead” of competing limit orders by submitting an order with an economically insignificant price enhancement in order to gain execution priority. SIFMA believes that attaining priority for an economically insignificant amount could reduce the incentive for liquidity providers to publish limit orders.

The Program’s potential impact on our existing market structure could compromise the fairness that is paramount to our markets and/or could have adverse consequences for both retail and institutional investors. As such, SIFMA believes that the Exchanges’ proposals in their current form are not consistent with the requirements of Section 6(b)(5) of the Exchange Act and the Commission therefore should not approve them. In addition, as noted above, if the SEC were to consider providing an exemption from Rule 612 to allow sub-penny quoting, SIFMA

¹³ See Exchange Act Release No. 50870 (Dec. 16, 2004), 69 FR 77424 (Dec. 27, 2004).

¹⁴ 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; *see 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.

¹⁵ See Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA to Elizabeth M. Murphy, Secretary, Commission dated April 29, 2010; *see also* Exchange Act Release No. 61358 (Jan. 14, 2010), 75 FR 3594 (Jan. 21 2010) (“Market Structure Concept Release”).

believes that such exemption should be subject to the SEC rulemaking process, rather than be considered through a rule proposal of a single market participant. It is important that the SEC address the comments on the possible consequences and detriments that sub-penny quoting could have on the marketplace, as described in greater detail in previous SIFMA comment letters referenced herein.

C. The Exchanges' Proposals Are Inconsistent with Regulation NMS Fair Access Standards

The proposals' plan for quote dissemination raises fair access concerns under Regulation NMS, which in turn raises questions regarding a firm's best execution and OPR obligations, because, among other things, it is unclear who will qualify for the Program and which factors the Exchanges will consider in making such a determination. As specifically noted by the Commission in the SEC Order, "the proposals would create a new exchange order type – the Retail Price Improvement Order – that is available only to a subset of market participants, namely Retail Member Organizations."¹⁶

Under Regulation NMS, a market is permitted to have tiers of categories of access if there are bona-fide reasons for doing so (*e.g.*, a specific fee structure). While SIFMA believes that the Exchanges should be permitted to set tiers for participation or for economic benefit, the Exchanges should not be able to subjectively exclude certain participants from participating in the Program. In that regard, although the Exchanges have proposed certain objective criteria in connection with maintaining RLP status, the Exchanges have also retained the ability, in their sole discretion, to determine whether and when an RLP is disqualified from service. Without objective and transparent criteria as to who qualifies to participate in the Program, the discrimination could be "unfair" to certain market participants and, therefore, inconsistent with the requirements of Section 6(b)(5) of the Exchange Act.

While we understand that the Exchanges hold out the possibility that the RLI will be integrated into the public market data stream,¹⁷ the Program, at least initially, contemplates both selective viewing of data through a proprietary data feed and selective access to that quote. Specifically, the Exchanges will be providing selective access via a RLI, a flag that indicates that a better price exists on the exchange, which will, in its current form, be distributed through

¹⁶ Additionally, the Commission states: "Accordingly, given the breadth of the proposed definition of a "Retail Order," the Commission believes questions are raised as to the scope of the requested exemption under the Sub-Penny Rule, and whether the Exchanges have fairly and reasonably determined the subset of market participants that would be allowed to access Retail Price Improvement Orders."

¹⁷ In Amendment No. 1 to the Exchanges' proposals, the Exchanges state the following: "Based on preliminary conversations with members, the Exchange understands that the industry would prefer to see the Retail Liquidity Identifier integrated into the public market data stream and is working with the Securities Information Processor to make this broader distribution available. The Exchange will advise via Trader Update if and when the Retail Liquidity Identifier becomes available over the public market data stream." Even if the RLI is eventually integrated into the public market data stream, SIFMA believes that the possible changes to the Securities Information Processor feeds for the Exchanges' business models should be dealt with through SEC rulemaking and subject to the full notice and comment process and industry discussion, rather than in the context of an exchange rule filing.

proprietary market data feeds. Market participants that do not pay for this proprietary data feed, which often may be smaller firms, will not have access to this liquidity information. Also, even if market participants can access the proprietary data feeds, they will be unable to access the quote unless they can attest that the request is to fill an order for a retail customer. This requirement thus precludes institutional investors from accessing that quote. The Program is therefore inconsistent with the requirements of Section 6(b)(5) as it, among other things, allows for unfair discrimination between market participants.

In addition, in the Commission’s Market Structure Concept Release, the Commission indicated that it was examining the differences between public and private data feeds and, specifically, the latency between these feeds.¹⁸ Similarly, in the Commission’s 2009 Flash Order Release,¹⁹ the Commission examined issues associated with selective access to proprietary feeds. Given that the Commission is currently examining these issues, SIFMA believes that it is premature for the Commission to approve the Exchanges’ proposed rule changes, which raise selective access concerns and appear to run contrary to the mandate in Regulation NMS for open, non-discriminatory access to quotes.

SIFMA firms are also concerned that the Exchanges’ rule proposals could set a precedent for other exchanges to discriminate among members. Although many exchanges currently discriminate among members in their pricing (*e.g.*, with trading fees frequently based on volume tiers and/or coupled with obligations to provide liquidity), other than the NYSE designated marker maker program, no other equities exchange currently offers different order type functionality to different members or matches orders differently based on the member that sent the order. SIFMA firms therefore believe that additional specificity regarding the type and extent of discrimination that exchanges may engage in is necessary prior to the Commission approving the Exchanges’ proposed rule changes.

SIFMA also believes that the repropose definition of the term “Retail Order” is vague. In that regard, while in Amendment 2 the Exchanges have eliminated one category of order from the definition of “Retail Order” – proprietary orders of RMOs, there still remain important open issues with respect to this definition. To qualify as a Retail Order, in addition to the requirement that orders be agency orders from a natural person submitted to the Exchanges by an RMO that are not modified, the orders cannot “originate from a trading algorithm or any computerized methodology.” It is unclear as to exactly what the Exchanges intended to cover with this statement. Read broadly, this statement could be read to mean that retail brokers will be required to submit orders via phone. Additionally, this could also be read to mean that the orders entered through an online broker by an actual retail customer would not qualify. It is also uncertain whether the use of a smart order router would be equivalent to the use of a trading algorithm or

¹⁸ See Market Structure Concept Release, *supra* note 15. The Commission stated, “Given the extra step required for SROs to transmit market data to plan processors, and for plan processors to consolidate the information and distribute it to the public, the information in the individual data feeds of exchanges and ECNs generally reaches market participants faster than the same information in the consolidated data feeds.”

¹⁹ See Exchange Act Release No. 60684 (Sep. 18, 2009), 74 FR 48632 (Sep. 23, 2009).

computerized methodology. This has the potential of preventing orders that are truly retail in nature from qualifying for the Program.

D. Best Execution and Order Protection Rule Obligations

The distribution of and access to quotes on the RLP also raises concerns for firms in meeting their best execution and OPR obligations. Specifically, SIFMA member firms question whether the RLI can be ignored if it is a better price than the NBBO, or whether it must be considered in determining firms' obligations. In that regard, if the RLI is deemed to be an actionable IOI/de facto quote (*i.e.*, easily determinable implicit price and size), the Quote Rule may require that the RLI be displayed, which could cause best execution and OPR issues. The Program therefore has the potential to create uncertainty among broker-dealers in regard to their best execution and OPR obligations and possibly creates an unlevel playing field.

Also, since the OPR requires firms to access better-priced ("protected") quotes, which are the best prices displayed on market data feeds, most firms' smart order routers are currently programmed to access the best price they see via the feeds used; these systems would have to be reprogrammed to ignore the RLI if it is not considered protected. Finally, SIFMA notes that, if other markets are granted similar sub-penny exemptions, there is a potential for even greater confusion among market participants regarding which is the best available market to access (unless sub-penny quotes and sizes are included in the consolidated quote, which in turn raises the concerns mentioned previously).

E. The Exchanges' Rule Proposals Unfairly Burden Competition

The Exchanges are specifically requesting an exemption that other exchanges and trading centers do not have. The isolated approval of sub-penny quoting for one market participant may create an unlevel playing field and thus compromise the fairness that is paramount to our markets. It remains unclear what the impact will be of certain, different obligations between the Exchanges and broker-dealers, particularly when the Exchanges are operating what is effectively a "dark pool" for retail flow; for example, firms have a Manning obligation whereas the Exchanges do not, and it is unclear what the expectations are regarding the Exchanges' price/time priority requirements. This further supports the position that the proposed rule changes do not meet the requirements of Section 6(b)(5) of the Exchange Act and therefore the Commission should not approve such proposed rule changes.

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SIFMA appreciates the Commission's consideration of the issues raised above in connection with the Exchanges' rule filings. SIFMA would be pleased to discuss these comments in greater detail with the Commission and the Staff. If you have any questions, please contact me at avlcek@sifma.org or 202-962-7300.

Sincerely,



Ann L. Vlcek
Managing Director and
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SIFMA

cc: Mary L. Schapiro, Chairman
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