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April 10, 2012

VIA E-MAIL AND FEDERAL EXPRESS

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

Re: Securities Exchange Act Release No. 34-66346 (File Nos. SR-NYSE-2011-55 and SR-NYSEAmex-2011-84); Order Instituting Proceedings to Determine Whether to Disapprove Proposed Rule Changes, as Modified by Amendments No. 1, 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--Partial Amendment No. 2; Response to Comment Letters ("Response")

Dear Ms. Murphy:

NYSE Euronext, on behalf of New York Stock Exchange LLC ("NYSE") and NYSE Amex LLC ("NYSE Amex," collectively with NYSE, the "Exchanges"), submits this letter in response to two comment letters received by the Securities and Exchange Commission (the "SEC" or the "Commission") in connection with Partial Amendment No. 2 to the above-referenced files, which propose to establish a Retail Liquidity Program (the "Program" or "Proposal") on a pilot basis to attract additional retail order flow to the Exchanges.

I. Summary of the Retail Liquidity Program

On October 19, 2011, the Exchanges filed with the Commission a proposed rule change to establish on a one-year pilot basis a Retail Liquidity Program.[1] Following a notice and comment period and a designation by the Commission on December 19, 2011, of a longer period for Commission action,[2] the Exchanges submitted a consolidated response on January 3, 2012,[3] to the 32 comment letters received, and Amendment No. 1 to the proposal on

[1] Exchange Act Release No. 65672, 76 Fed. Reg. 69788 (November 9, 2011) ("Proposal").

[2] Exchange Act Release No. 66003, 76 Fed. Reg. 80445 (December 23, 2011).

[3] *See* Letter to the Commission from Janet McGinness, Senior Vice President—Legal & Corporate Secretary, Legal & Government Affairs, NYSE Euronext, dated January 3, 2012 ("Response to Comments").

January 17, 2012. On February 7, 2012, the Commission issued an order instituting proceedings to determine whether to disapprove the proposal, as modified by Amendment No. 1 ("the February 7th Order").[4] On March 20, 2012, the Exchanges submitted a comment and rebuttal letter to the February 7th Order.[5] Concurrently with the initial filing of the proposal on October 19, 2011, the Exchanges filed a request for exemptive relief under the Sub-Penny Rule describing the Program's consistency with the policy objectives of the Sub-Penny Rule and its furtherance of the public interest and protection of investors.[6] The Exchanges amended the request for exemptive relief on January 13, 2012.[7]

As discussed more fully in the above-referenced files, the Exchanges have proposed the Program to attract additional retail order flow to the Exchanges for NYSE and NYSE Amex-traded securities while also providing the potential for price improvement to such order flow. For the reasons set forth in those files, the Exchanges believe that the Program has the potential to enhance price competition and transparency in relation to current retail order execution arrangements and to thereby deliver better prices to retail investors. The Program would create two new classes of market participants: Retail Member Organizations ("RMOs") and Retail Liquidity Providers ("RLPs"). An RMO is a member organization approved by the Exchanges to submit Retail Orders. An RLP is a member organization approved by the Exchanges that agrees to provide liquidity to interact with orders submitted by RMOs with at least a minimum amount of price improvement, currently specified at $.001 per share. RLPs would not be assured of the opportunity to interact with Retail Orders, but rather would be required to compete based on price improvement for execution priority. The Exchanges would disseminate a Retail Liquidity Identifier ("RLI") when interest priced $.001 better than the protected best bid (PBB) or protected best offer (PBO) is available. RLIs would not contain prices or sizes.

The Exchanges filed Partial Amendment No. 2[8] to the above-referenced files, which proposed to make three changes to the Program: (1) modify the definition of a "retail order" to exclude proprietary orders that result from liquidating a position acquired from the prior internalization of a retail order; (2) amend the definition of Retail Orders and RPIs to clarify that both may include odd lot, round lot, and part of round lot orders; and (3) amend the definition of RLI to clarify that the RLI shall reflect the symbol and side, but not the price or size, of the interest.

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4 *See* Exchange Act Release No. 66346, 77 Fed. Reg 7628 (February 13, 2012) ("February 7th Order").

5 *See* Letter to the Commission from Janet McGinness, Senior Vice President—Legal & Corporate Secretary, Legal & Government Affairs, NYSE Euronext, dated March 20, 2012 ("Rebuttal Letter").

6 *See* Letter to the Commission from Janet M. McGinness, Senior Vice President—Legal & Corporate Secretary, Office of the General Counsel, NYSE Euronext dated October 19, 2011 ("Sub-Penny Rule Exemption Request").

7 *See* Letter to the Commission from Janet M. McGinness, Senior Vice President—Legal & Corporate Secretary, Office of the General Counsel, NYSE Euronext dated January 13, 2012 ("Amended Sub-Penny Rule Exemption Request").

8 Exchange Act Release No. 66464, 77 Fed. Reg. 12629 (March 1, 2012) ("Partial Amendment No. 2").

II. Summary of Comments and Exchanges' Response

At the time of the filing of this Response, the Commission has received two comment letters relating to Partial Amendment No. 2 to the Program.[9] The Exchanges note that many of the issues raised by the commenters have been addressed in previous filings, and the Exchanges request that the Amended Sub-Penny Rule Exemption Request, consolidated response to comments on the Proposal, and the Comment and Rebuttal letter be incorporated by reference to this Response. Before addressing the comments on an issue-by-issue basis, summarizing previous responses as appropriate, the Exchanges observe the following preliminary points.

The Exchanges continue to believe that the Proposal represents an important yet structurally modest effort to enhance the price competition and transparency associated with the execution of retail orders within the currently segmented environment.[10] The Program would parallel—but significantly enhance—the internalization arrangements that have been operating between liquidity providers and firms handling retail orders for well over a decade. The Exchanges appreciate the Commission's view that the Proposal "raise[s] novel market structure issues that warrant further comment and Commission consideration."[11] We believe we have fully responded to the specific concerns identified by the Commission related to the Sub-Penny Rule, the Quote Rule, the definition of Retail Order, and the details associated with the RLI.[12]

Yet the comments continue to raise market structure issues that have already been thoroughly considered and decided by the Commission.[13] A commenter also conjures up the specters of

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9 Letter from Ann L. Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated March 23, 2012 ("SIFMA"); letter from Kurt Schacht, Managing Director, CFA, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated March 21, 2012 ("CFA"), dated March 21, 2012.

10 *See infra* Section II(C).

11 *See* February 7th Order.

12 *See* Amended Sub-Penny Exemption; Partial Amendment No. 2; Rebuttal Letter. The Exchanges will also file a request for exemptive relief from the Quote Rule, describing the Program's consistency with the policy objectives of the Quote Rule and its furtherance of the public interest and protection of investors.

13 For example, one commenter raised issues with proprietary data feeds and access fees. With respect to the feed latency issue, the commenter notes that "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." SIFMA at 8. Similarly, in the Commission's 2009 Flash Order Release, the Commission examined issues associated with selective access to proprietary feeds. *See* Securities Exchange Act Release No. 60684 (September 18, 2009), 74 FR 48632 ("Flash Order Release"). As discussed below, these references serve to complicate unnecessarily the consideration of the Proposal. As discussed below and previously, the Program's liquidity flag will be available upon implementation in the public market data feed, and not selective in any sense. More fundamentally, the liquidity flag has far *less* information (no price or size) than the pricing information that the Commission has already allowed to be distributed through both the public data stream and proprietary feeds, and therefore adds nothing to the concerns under consideration. Finally, to suggest that because the Commission is *examining* a broad structural issue, approval of any exchange proposal that potentially touches that issue is premature is to interpose a persistent obstacle to innovation that has no rightful place in the National Market system. With

"two tiered markets" and sub-penny pricing encouraging participants "to 'step ahead' of competing limit orders . . . ."[14] As discussed previously and below, the Program, with its open access, its incorporation of the liquidity flag into the public market data stream, and its potential to deliver better prices to retail investors, bears no resemblance to a two-tier or hidden market "where professionals can see and access more competitive sub-penny quotations that average investors cannot . . . ."[15] Nor does the Program do anything to enable any order to gain execution priority against a displayed public limit order that the order does not already have under the current market structure. The Exchanges would welcome a broad and comprehensive debate about how to address venues where professionals may be able to see prices that the average investor cannot, and how to enhance the execution priority of displayed limit orders, but it is not appropriate or consistent with national market system policy to delay the current Proposal until the debate concludes.

The Exchanges also note that a commenter believes it would be "premature for the Commission to approve the Exchanges' proposed rule changes,"[16] notwithstanding the lengthy review the Program has already undergone. The commenter seems to suggest that the Commission needs to resolve open market structure issues before the Exchanges may proceed with the Program, notwithstanding that firms already engage in these practices, albeit away from registered exchanges.[17] In contrast to the commenter's suggested sub-penny rulemaking approach, Rule 612(c) specifically provides a mechanism whereby the Commission can flexibly and efficiently provide exemptive relief from Rule 612.[18] In adopting Rule 612 and the prohibition of sub-penny quoting, the Commission previewed "the possibility that the balance of costs and benefits could shift in a limited number of cases or as the markets

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respect to the inclusion of access fees in the quote, which the commenter refers to as a "lengthy, unresolved debate over the years[,]" the Exchanges would note the Commission's view of the resolution provided by Reg. NMS's Access Rule: "[a]lthough consensus could not be achieved on any particular approach, commenters expressed a strong desire for resolution of a difficult issue that had caused discord within the securities industry for many years." *See* SIFMA at 2, fn. 4; NMS Adopting Release at 37503; s*ee also* NMS Adopting Release at 37502 (providing a reflection of the Commission's apparent sense of relief with the resolution in its remark that "[p]erhaps more than any other single issue, the proposed limitation on access fees splintered the commenters").

14 SIFMA at 2, 6.

15 NMS Adopting Release at 37555.

16 *See* SIFMA at 8.

17 Specifically, the commenter takes the position that: (1) "decisions related to the minimum quotation increment should only be made after a thorough SEC notice and comment rulemaking process[,]" rather than through an application for exemption specifically provided in Rule 612; (2) in connection with the liquidity flag, "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"; and (3) "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." *See* SIFMA at 5, 7.

18 17 C.F.R. 242.612(c).

continue to evolve" and provided express exemptive authority to address such changes.[19] The Commission, notably, has granted exemptive relief on at least two previous occasions.[20] Requiring exchanges to wait for Commission rulemaking while other market participants continue to operate within the current framework would leave the efforts of exchanges to innovate in a state of suspended animation.

A. For reasons previously stated, the RLI is not a bid or offer or quotation.

One commenter repeated its previous contention that the RLI is a quote, as defined in Regulation NMS, and therefore subject to Rule 602 of Regulation NMS ("Quote Rule").[21] The same commenter quotes the Commission's Proposed Rule on Regulation of Non-Public Trading Interest ("the Dark Liquidity Proposal"),[22] stating that the Commission "preliminary believes that the quoting requirements of Rule 602 and Regulation ATS should clearly cover actionable IOIs."

The Quote Rule's applicability is dependent on the definition of "bid" or "offer" under Rule 600(b)(8) of Regulation NMS, which states in pertinent part:

> *Bid* or *offer* means the bid price or the offer price communicated by a member of a national securities exchange . . . to any broker or dealer, or to any customer, at which it is willing to buy or sell one or more round lots of any NMS security, as either principal or agent, but shall not include indications of interest.[23]

As stated in the Exchanges' Response to Comments[24] and Rebuttal Letter,[25] the Exchanges believe that the non-displayed RPIs, considered either on their own or together with the liquidity flag that indicates their existence, do not meet the definition of "bid" or "offer" in

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19 Securities Exchange Act Release No. 51808, 70 Fed. Reg. 37496, 37554 (June 29, 2005) ("NMS Adopting Release").

20 *See* Exchange Act Release No. 54714 (November 6, 2006) (granting National Securities Exchanges an exemption to accept cross orders arranged by members that are priced in sub-penny increments and immediately executed against each other); Exchange Act Release No. 53193 (January 30, 2006) (granting Liquidnet, Inc. an exemption from the Sub-Penny rule with respect to orders generated by its midpoint functionality). Importantly, sub-penny quoting is not being proposed by the Program, but rather only the acceptance and ranking of orders in sub-penny increments. Given the Program's potential to enhance price competition for retail orders, the Proposal is therefore especially fitting for exemptive relief under the Rule. In any case, utilizing the exemptive mechanism expressly provided by Rule 612 is a far more efficient approach than the Commission rulemaking proposed by the commenter.

21 SIFMA at 3-5.

22 *See* Exchange Act Release No. 60997 (November 13, 2009), 74 Fed. Reg. 61208 (November 23, 2009) ("Dark Liquidity Proposal").

23 17 C.F.R. 242.600(b)(8).

24 *See* Response to Comments at 10-12.

25 *See* Rebuttal Letter at 5-6.

Rule 600(b)(8) because RPIs are not displayed and because the liquidity flag does not contain a price.

The Exchanges understand that the Commission's Dark Liquidity Proposal would amend the definition of bid or offer set forth in Rule 600(b)(8). However, a preliminary statement in a proposing release about changes or clarifications that *should be adopted, but have not been* does not change the fact that the RLI does not contain a price, and therefore, is not a quotation under current regulation. Additionally, even if the Commission were to view the RLI as substantially similar to a quote, the Program's potential to improve price competition for retail orders and deliver better prices to retail investors squarely favors providing the Program no-action relief from the Quote Rule.

B. The Program would not jeopardize the incentives to place limit orders or otherwise implicate the customer protection concerns addressed by the Sub-Penny Rule because RPIs would not gain any execution priority against displayed public limit orders that they do not already have under the current market structure.

One commenter voiced concerns that the Program will have adverse consequences for market integrity since investors will submit fewer displayed limit orders, thus having a detrimental effect on public price discovery and market quality.[26] While we appreciate the seriousness of this concern, it is important to recognize that our current market structure does not protect a publicly displayed limit order against an internalizing order trading *at the same price*, not to mention an order priced at a sub-penny increment better. There are valid reasons to question this aspect of the U.S. equities' overall market structure and to continue to monitor it as the Commission has for more than a decade,[27] and the Exchanges welcome the continuing market structure debate about how to provide appropriate incentives to display liquidity. The Proposal, however, seeks to operate within the current reality and to stimulate price competition within it through the Program's multiple liquidity providers, priority rules, and minimum price improvement. The Exchanges respectfully submit that the national market system's embrace of competition among markets[28] and the Program's potential to improve price competition, transparency, and the prices received by retail investors favor allowing the Exchanges to compete in the proposed manner.

Another commenter expressed concerns about sub-penny quoting and stated that their concerns should be addressed through Commission rulemaking.[29] As previously stated,[30] the

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[26] CFA at 2-3.

[27] Securities Exchange Act Release No. 42450 (February 3, 2000), 65 FR 10577, 10580 (February 28, 2000) ("Fragmentation Concept Release").

[28] NMS Adopting Release at 37633; *see* H.R. Rep. No. 94-229, 94th Cong., 1st Sess. (1975) ("Conference Report"), at 92.

[29] SIFMA at 5-7.

[30] *See* Response to Comments at 6-8; Rebuttal Letter at 4-5; Amended Sub-Penny Rule Exemption Request.

Program does not involve the display of sub-penny quoting increments. The Program does involve sub-penny *trading*, a practice long-established and recognized by the Commission as benefitting investors. The Commission's guidance makes clear that the execution priority of visible trading interest was the focus of the Commission's concern with sub-pennies. The Commission consistently articulated its concern about sub-penny trading in terms of a market professional "stepping ahead" and gaining execution priority[31] over customer limit orders or customers losing execution priority to a later arriving quotation or order.[32] These references assume that both the disadvantaged limit order and the order stepping ahead are displayed. Because RPIs are undisplayed and RLIs are unpriced, there is no possibility of RPIs gaining execution priority against a displayed public limit order that they do not already have under the current market structure, and therefore, the concerns addressed by Rule 612 are not implicated.

C. The Program does not unfairly discriminate among members because the limitation of Retail Orders to RMOs simply reflects the segmented nature of the retail executions and allows retail investors to benefit from the desirability of their orders to liquidity providers.

One commenter expressed concern that the Program could set a precedent for other exchanges to discriminate among members, stating that no other equities exchange currently offers different order type functionality or matching based on the member that sent the order.[33] The Exchanges believe that the approval process for both RMOs and RLPs is open and transparent, and not unfairly discriminatory in any respect. Moreover, the limitation of a Retail Order to RMOs is simply a mechanism that allows retail order flow to be reliably identified, and for retail investors to benefit from that identification. Specifically, the execution of retail orders today occurs in a largely segmented environment. Broker-dealers executing retail orders currently do not compete for those orders by offering aggressive prices in a competitive market mechanism, but rather through bilateral internalization arrangements.[34]

The Commission has recognized this segmentation and its underlying economics, stating that "[l]iquidity providers generally consider the orders of individual investors very attractive to trade with because such investors are presumed on average not to be as informed about short term price movements as are professional traders."[35] While continuing to express broad

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[31] Exchange Act Release No. 49325 (February 26, 2004), 69 Fed. Reg. 11126, 11166 ("Reg. NMS Proposing Release") (defining "stepping ahead" or "pennying" as "attempting to gain execution priority by improving the best bid by a penny").

[32] NMS Adopting Release at 37588.

[33] SIFMA at 8.

[34] *See* Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3594, 3606 ("Equity Market Structure Release") ("[B]rokers with significant retail customer accounts send the great majority of non-directed marketable orders to OTC market makers that internalize executions, often pursuant to payment for order flow arrangements.").

[35] *Id.* at 3612.

market structure concerns with respect to internalization arrangements, the Commission has noted specifically that the arrangements offer certain benefits to retail investors.[36] The Program's order type and matching functionality simply reflect the reality of the current segmentation of retail order flow, and an effort to enhance the benefit (better prices) that segmentation may offer to retail investors. Accordingly, there is no basis for the commenter's concern that that the Proposal could set a discriminatory precedent.

D. The RLI would be disseminated through the public market data stream when initially implemented, and therefore does not implicate the purported concerns regarding proprietary data feeds.

One commenter raised concerns about the RLI being disseminated only through a proprietary data feed.[37] The RLI would be disseminated through the public market data stream as part of the initial implementation of the Program, obviating the concerns expressed with respect to proprietary data feeds.

E. The Program presents no new best execution concerns.

One commenter stated that the Program raises concerns for firms in meeting their best execution obligations.[38] As previously stated,[39] the Exchanges understand the range of choices that brokers face as they consider execution venues in today's dynamic environment. While brokers would begin to consider the Program's execution quality statistics in their routing decisions, there would be little new in this process since brokers have become accustomed to the continuing appearance of new exchanges, ATSs, and OTC market makers.

Applicable best execution guidance contains no formulaic mandate as to whether or how brokers should direct orders to the Program, but rather, continues to involve a facts and circumstances consideration of execution venues by brokers routing customer orders. Broker-dealer internalization venues already operate in a structurally similar manner to that proposed in the Program. The best execution obligations faced by brokers in evaluating the Program as an execution venue would therefore not present substantially new challenges.

F. The RLI would not be a protected quote and therefore does not implicate the Order Protection Rule.

One commenter raised concerns that the Order Protection Rule would be implicated by the dissemination of the RLI.[40] As discussed above, the Exchanges respond that the RLI is not a quote, and therefore, the Order Protection Rule is not implicated.

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36 *Id.* at 3597.

37 SIFMA at 7-8.

38 SIFMA at 9.

39 *See* Response to Comments at 12-13.

40 SIFMA at 9.

G. The Exchanges commit to providing further clarification with respect to the definition of the term "Retail Order," as required.

One commenter raised concerns about the vagueness of the clarified definition of the term "Retail Order."[41] The Exchanges do not believe that the language referenced by the commenter excluding orders originating from a trading algorithm or computerized methodology presents meaningful interpretive ambiguities. The Exchanges encourage firms who remain confused by terms used in the Program to contact the Exchanges to resolve any remaining questions.

III. Conclusion

For the reasons set forth above and incorporated herein, the Exchanges do not believe that the commenters have identified concerns that would support disapproving the Proposal. The Exchanges therefore respectfully request that the Commission approve the Proposal.

Very truly yours,

41 SIFMA at 8-9.