



August 28, 2009

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

**RE: Proposals to Expand the Options Penny Pilot**  
**Release No. 34-59944, File No. SR-NYSEArca-2009-44**  
**Release No. 34-60018, File No. SR-CBOE-2009-31**  
**Release No. 34-60146, File No. SR-ISE-2009-32**

Ms. Murphy:

BATS Exchange, Inc. ("BATS") appreciates the opportunity to comment on the above referenced proposals related to the expansion of the Options Penny Pilot ("Pilot"). BATS supports the efforts of the Options Exchanges to expand the current program. As the Commission and the exchanges have incrementally introduced finer pricing increments to the options markets, it has given market participants the opportunity to measure the benefits of penny pricing as they have adjusted their technology and trading practices. It is clear; the benefits of the penny trading increments have been substantial - better prices and tighter spreads. Beyond expanding the Pilot program, it should be made a permanent fixture of the options markets.

BATS recommends a continued expansion of penny pricing in equity options with a goal of eventually adopting a universal penny pricing structure for all option classes. Penny pricing gives market participants the flexibility to trade with spreads at six or eleven cents wide, as much as it facilitates trading in one or two cent spreads. With the substantial narrowing of the spread in Pilot securities, it is clear that the previous pricing increments were unnecessarily and arbitrarily wide, yielding gratuitous free rent to a small number of market makers.

A full review the Penny Pilot Reports submitted by the existing options exchanges<sup>1</sup> shows clear benefits to the markets of penny pricing increments. In the review period ending January 31, 2009 average spread width decreased by an average of 14% for Phase I classes, 18% for Phase II classes and by 20% for Phase III classes. As noted by the CBOE in their most recent penny pilot report, this reduction occurred despite extraordinary market conditions. "[A]verage

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<sup>1</sup> See [http://www.bostonoptions.com/box1Penny\\_en](http://www.bostonoptions.com/box1Penny_en), <http://www.cboe.org/hybrid/pennypilot.aspx>, <http://www.ise.com/WebForm/viewPage.aspx?categoryId=152>, <http://www.nyse.com>, <http://www.nasdaqtrader.com/Micro.aspx?id=PHLXRegulatoryInfo#secpenny>

spread width reductions are significantly less than in prior review periods, in which the average spread width consistently decreased in the range of 40-50%.<sup>2</sup>

We see no breakdown in this analysis and reasoning when factoring in security price. As a result, we see no compelling need for a penny pricing breakpoint threshold. If the Commission decides that breakpoint thresholds (over which the minimum pricing increment is larger than a penny) are necessary, BATS is of the opinion that the increment should be as small as possible and the thresholds as high as possible. With regards to breakpoints, nickel pricing increments for options with a premium over \$10.00 would be preferred over nickel pricing increments for options trading with a premium over \$5.00. Similarly, we prefer nickel pricing increments over dime increments. Generally, we believe that full access to penny increments provides investors with more flexibility to compete and to determine the natural spread for each security independently. It is important to note that penny pricing increments does not require trading in penny spreads. In the analysis period ending January 31, the average spread in OIH options (a Phase II class) increased from \$0.13 to \$0.19 a 52% increase. Without the ability to quote OIH options in penny increments, what was a \$.06 increase could easily have been magnified to become a \$0.10 increase.

In this regard, of the three exchange proposals referenced above, NYSE Arca's<sup>3</sup> proposal is the most aligned with the BATS view of the evolving options market structure and the direction we believe best suited for all investors. The CBOE<sup>4</sup> and the ISE's<sup>5</sup> proposals both contain some level of rollback of penny pricing that has already occurred. Any level of rollback to a pilot that is proving successful would be unfortunate given the benefits already realized by participants when trading in the pilot securities. We recommend moving forward, as opposed to taking steps backward as these markets have proposed.

BATS notes the Commission's concerns regarding the ability of existing technology to cope with greater volumes of market data resulting from smaller pricing increments. We firmly believe that the markets are integrally tied to the adoption of new technology – penny pricing does not change this. Market participants, including BATS, will continue to make the investment in technology that result in more efficient markets. In the six months ending January 31, the OPRA message rate from the exchanges expanded to nearly three quarters of a million messages per second, a 27% expansion from the rate only months prior. We note that during this extremely volatile period in the markets, the listed equity options exchanges performed nearly flawlessly. Many of the exchanges have doubled the number of physical network connections between themselves and OPRA as a result. The ISCA (who has factored a BATS entry into the options markets into their projections), projects peak message rates of nearly four million messages per second by the end of 2011. We applaud the managed approach that has been used in expanding penny pricing and believe that continuing the expansion in this manor allows for all

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<sup>2</sup> See <http://www.cboe.org/hybrid/CBOEPennyPilotReport3-9-09.pdf>

<sup>3</sup> See <http://www.sec.gov/rules/sro/nysearca/2009/34-59944.pdf>

<sup>4</sup> See <http://www.sec.gov/rules/sro/cboe/2009/34-60018.pdf>

<sup>5</sup> See <http://www.sec.gov/rules/sro/ise/2009/34-60146.pdf>

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Page 3 of 3

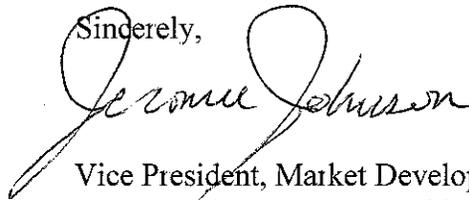
of the exchanges as well as industry utilities like OPRA to continue to make adjustments and enhancements.

To sum up, the benefits of the penny trading increments in equity options are clear and that beyond expanding the Pilot program, it should be made a permanent fixture of the options markets. As BATS starts the process of becoming an options exchange, we look forward to working with the Commission and the other exchanges on this and other options industry issues.

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BATS appreciates the opportunity to comment on the Options Penny Pilot. Please contact the undersigned at 913.815.7143 with any questions you may have in connection with this matter.

Sincerely,



Vice President, Market Development  
BATS Exchange, Inc. ... Making Markets Better

cc: The Hon. Mary L. Schapiro, Chairman  
The Hon. Kathleen L. Casey, Commissioner  
The Hon. Elisse B. Walter, Commissioner  
The Hon. Luis A. Aguilar, Commissioner  
The Hon. Troy A. Paredes, Commissioner  
James Brigagliano, Co-Acting Director, Division of Trading and Markets  
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