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June 12, 2009

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington D.C. 20549-0609

Re: CBOE Comments on SR-NYSEArca-2009-44

Dear Ms. Murphy:

The Chicago Board Options Exchange, Incorporated (“CBOE”) is writing in reference to the above-captioned rule filing by the NYSEArca, which proposes to amend and expand the industry-wide Penny Pilot Program. As detailed below, CBOE believes that the more thoughtful, flexible and better approach for expanding the Penny Pilot Program is the proposal that CBOE has recommended for over one year and which the Equity Options Trading Committee of SIFMA has endorsed. CBOE’s proposal to expand the Penny Pilot is described in its rule filing SR-CBOE-2009-31, which has been published for comment by the SEC and is available on the SEC’s website at <http://www.sec.gov/rules/sro/cboe.shtml> and on CBOE’s website at <http://www.cboe.org/Legal/SubmittedSECFilings.aspx>. CBOE encourages all market participants who are concerned about how and when the Penny Pilot may be expanded to express their views to the SEC and support CBOE’s proposal by commenting in support of it.

NYSEArca’s Proposal

In its rule filing, NYSEArca proposes to expand the Penny Pilot Program by adding the top 300 most active, multiply listed option classes not currently in the Pilot Program. NYSEArca would add these 300 classes in increments of 75 classes over the course of four quarters - in July 2009, October 2009, January 2010 and April 2010. NYSEArca also proposes to have all options series in the SPY options class and the IWM options class (two ETFs which are currently participating in the Penny Pilot) quote/trade in penny increments, like the QQQQ options. Today, for SPY and IWM, the minimum increment for bids and offers is a penny for all option series below \$3, and nickels for all option series \$3 and above.

CBOE believes that the NYSEArca proposal is imprudent and simplistic, and appears to CBOE to be motivated solely by the business model that NYSEArca has adopted, namely, maker-taker. NYSEArca does not reasonably consider the effect of its proposed expansion of the Penny Pilot on all market participants, exchanges, and market data vendors. CBOE has the following specific comments with respect to the NYSEArca proposal:

- 1) The NYSEArca proposal does not consider the cost and impact on the systems capacity of the exchanges, members and vendors of adding the next 300 most active, multiply listed option classes to the Pilot, or whether the cost of the continued explosion of quote traffic is outweighed by other expected benefits of expanding the Penny Pilot as proposed. Quote traffic, both into CBOE and to OPRA, continues to explode. During the most recent review period (February – April 2009), the industry’s total number of quotes per day in penny series increased 304% in Phase I classes, 187% in Phase II classes, and 177% in Phase III classes. As CBOE has pointed out in its reports to the SEC on the Penny Pilot, there are real costs to exchanges and others to process and store these quotations, which the NYSEArca proposal does not address. The peak message rate to OPRA from the exchanges currently is 852,350 messages per second, which is 18% greater than it was six months ago when the peak message rate was 724,586. Four exchanges have experienced peak message rates in the last month.
- 2) The NYSEArca proposal does not consider the confusion to investors that will likely ensue by having 355 option classes quoted in penny and nickel increments, three classes quoted solely in penny increments, and over 2,000 option classes quoted in nickel and dime increments. Nor does it explain how the cost of such confusion is outweighed by other expected benefits of expanding the Penny Pilot as proposed, or explain how the anticipated significant reduction in liquidity at the BBO in these next 300 classes would benefit investors and other market participants, or whether the cost of such a reduction is outweighed by other expected benefits of expanding the Penny Pilot as proposed. The data reflects that during the most recent review period (February – April 2009), the average quoted size in the penny series decreased 91% for the Phase I classes, 73% for Phase II classes, and 73% for Phase III classes. These numbers have been consistent throughout the Penny Pilot. CBOE believes its proposal, which would deliver certainty throughout the industry, would be much more preferable to users.
- 3) NYSEArca proposes to exclude option classes with “high premiums,” but gives no guidance, definition or indication of what constitutes a “high premium,” or which classes it would classify as a high premium class. For example, in the Google Inc. (GOOG) options class, which is a \$400+ underlying, the at-the-money calls with one week to expiration are currently trading around \$7. If that is what NYSEArca means by “high premium,” CBOE would suggest most options classes have at least some series that have similar “high premiums,” though presumably NYSEArca is not planning to exclude all these classes from any expansion. CBOE proposes a better standard, which is that all options series below \$1 in virtually every option class would eventually be quoted/traded in penny increments. This is a key part of CBOE’s proposal – to set a uniform standard for all equity and ETF option classes. The NYSEArca proposal suggests either an arbitrary standard, or an undefined one, which will only cause confusion among market participants.
- 4) As noted above, NYSEArca proposes that all option series in SPY options and IWM options would now be quoted/traded in penny increments. In its filing, NYSEArca states that “[i]n selecting these issues, the Exchange considered, among other things, that these symbols are (a) among the most actively traded issues nationally, with a wide array of investor interest, (b) have more series trading at a premium between \$3 and \$10, and (c) are trading at prices that are neither extremely low nor high, but are generally trading between \$15 – \$50.” CBOE finds this statement to be nonsensical in addition to being inaccurate. Neither the IWM nor SPY underlyings have recently traded to a low price even remotely close to \$15. The IWM is currently priced at \$53, having briefly touched

\$34.36 at the height of the financial crisis, but has averaged in the \$40-\$50 range as of late, and the SPY hit a 52-week low of \$67.10 in early 2009, but now trades above \$90. In fact, the SPY has never traded below \$50, so CBOE does not understand what data NYSEArca was using as a basis for this recommendation. If the \$15 to \$50 range relates to premium levels, then these two classes arguably should qualify as “high premium” classes under the NYSEArca’s undisclosed definition, in which case they would be excluded from the Penny Pilot entirely. In any event, CBOE does not understand how the amounts described immediately above, which were set forth in NYSEArca’s filing, provide support for its proposal with respect to SPY and IWM options. If NYSEArca was referring instead to net premium costs (*i.e.*, the posted market times the 100 multiplier), this is also perplexing since that would imply an options market price of \$.15 to \$.50, which is in line with CBOE’s proposal to implement penny increments in all series quoted below \$1 or less.

Also, CBOE does not find persuasive the NYSEArca’s conclusion that because IWM and SPY “have more series trading at a premium between \$3 and \$10,” the \$3 breakpoint should be eliminated in these two classes. Assuming that statement is true, it is misleading as it suggests there is significant volume being traded in these series. In fact, only 11% of IWM’s national ADV and only 18% of SPY’s national ADV is in series with a premium \$3 or greater. Moreover, the average spread width in series with a premium \$3 or greater is \$0.27 for SPY, and \$0.25 for IWM. These figures clearly do not support NYSEArca’s proposal to eliminate the \$3 breakpoint in these two classes.

- 5) The NYSEArca proposal does not contemplate the launch of the new Linkage Plan, which is scheduled to occur in the 3rd quarter of 2009, prior to any expansion of the Penny Pilot Program. CBOE believes strongly that the new Linkage Plan should be implemented before any expansion occurs because intermarket sweep orders (ISOs) will be available in the new Linkage Plan, and thus allow market participants to simultaneously access better priced quotations across all options exchanges. CBOE therefore recommends that at the very least, the NYSEArca proposal be amended to defer its proposed expansion until at least 30 days following the launch of the new Linkage Plan.

To the extent NYSEArca or anyone else might suggest that CBOE’s critical comments of the NYSEArca proposal are motivated by CBOE’s self-interest, such allegations could not be more inaccurate. CBOE has the highest market share in the current Penny Pilot classes among all options exchanges, and CBOE expects to continue to outperform its competitors as additional option classes are added to the Penny Pilot Program. However, CBOE continues to share the very real concern of most market participants and SIFMA that the execution costs for large customers, including institutions that manage a significant amount of retail investor assets, are not being considered in deliberations over the penny pilot.

CBOE Proposal

After studying the Pilot Program for over two years and speaking with liquidity providers, order flow providers, vendors, institutional investors, other market participants, and SIFMA, CBOE believes that the better approach to expand the Pilot Program is the proposal CBOE has recommended and which SIFMA has endorsed.

CBOE’s proposal is balanced, flexible and reasonable. It significantly expands the Pilot Program to all equity and ETF option classes (approximately 2,475 classes), such that at the end

of a brief roll-out period lasting approximately six months, all equity and ETF option classes would be included in the Penny Pilot Program. Moreover, in all Pilot classes, option series of less than \$1 premium value would be quoted in penny increments, and series at \$1 or above would be quoted in nickel increments. As such, CBOE's proposal:

- Provides the benefits of penny quoting and trading in those option contracts that customers actually trade. 57% of customer contract volume is in series priced up to \$1. In the Penny Pilot classes, 61% of customer contract volume is in series priced up to \$1;
- Introduces penny increments in nearly all listed option classes;
- Reduces the current dime increment to nickels in those same classes for series priced \$1 and above;
- Helps to reduce the explosion of quote traffic that would otherwise occur if the current \$3 breakpoint was maintained as part of a large expansion;
- Provides a simple and easily understood standard for investors as to which options are quoted in penny increments; and
- Provides flexibility in that if it is determined that the benefits of penny quoting at a breakpoint higher than \$1 outweigh any negatives, modifying the breakpoint would be fairly easy to implement.

CBOE's proposal also contemplates the launch of the new Linkage Plan prior to any expansion of the Penny Pilot Program. As noted above, CBOE believes strongly that the new Linkage Plan should be implemented before any expansion occurs.

The benefits of CBOE's proposal are clear: it provides for penny quoting and trading in a substantial percentage of option contracts that customers actually trade; it expands the Pilot to all equity and ETF option classes; it eliminates the confusion that will naturally result from quoting and trading some number of option classes in pennies and nickels and others in nickels and dimes; and it narrows the increment from a dime to a nickel in those series priced \$1 and above. Finally, it is flexible in that the breakpoint can be modified in subsequent years if it is deemed worthwhile to the industry overall.

CBOE notes that when the Penny Pilot initially was being developed, the SEC expressly authorized the exchanges to act jointly in developing the Penny Pilot in order to "facilitate the orderly transition to quoting standardized options in penny increments."¹ The SEC obviously believed that an orderly transition to quoting in penny increments would not be achieved if each of the exchanges submitted their own proposals for how such a pilot program should be structured -- which is the current state of affairs with NYSEArca, CBOE and ISE filing three very different proposals to expand the Penny Pilot. CBOE believed then that it was a good idea for the exchanges to act collectively with the SEC staff in designing the Pilot Program, and believes it is a good idea today for the SEC to expressly authorize the exchanges and other market participants to jointly determine with the SEC staff how the Penny Pilot Program should be expanded. To say the least, it would be confusing to firms and investors if the SEC were to approve multiple plans to expand the Penny Pilot Program.

¹ See letter from SEC Chairman Christopher Cox to CBOE Chairman and CEO William J. Brodsky, dated June 7, 2006.

CBOE appreciates the opportunity to comment on the NYSEArca proposal. We would be pleased to meet with you to discuss our comments as well as CBOE's separate proposal to expand the Penny Pilot Program as described in its rule filing SR-CBOE-2009-31.

Sincerely,

A handwritten signature in blue ink that reads "Edward J. Joyce". The signature is written in a cursive style with a large, stylized "E" and "J".

Edward J. Joyce

cc: Elizabeth King