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August 18, 2009

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

Re: Response to Comments on File No. SR-NYSEArca-2009-44

Dear Ms. Murphy:

NYSE Arca Inc. ("NYSE Arca" or "Exchange") appreciates the opportunity to respond to issues raised by comment letters submitted in response to the Exchange's proposal to extend and expand the Options Penny Pilot Program ("Penny Pilot") by the Securities Industry and Financial Management Association ("SIFMA"), the Chicago Board Options Exchange ("CBOE"), LiquidPoint LLC ("LiquidPoint"), TD Ameritrade, Inc. ("TD Ameritrade"), UBS Securities, L.L.C. ("UBS Securities"), and the International Securities Exchange, L.L.C. ("ISE") (collectively, the "Commenters").[1] The Commenters raised various issues regarding the Exchange's proposal to extend and expand the Penny Pilot. The issues raised generally addressed the following categories:

- Appropriate Scope of the Proposed Expansion;
- Exclusion of High Priced Or High Premium Underlying Securities;

[1] *See* Letter by Thomas F. Price, Managing Director, SIFMA, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 17, 2009, regarding File Numbers SR-NYSEArca-2009-44, SR-CBOE-2009-31, and SR-ISE-2009-32; Letter by Edward J. Joyce, CBOE, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 12, 2009, regarding File Number SR-NYSEArca-2009-44; Letter by Anthony J. Saliba, Chief Executive Officer, LiquidPoint, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 17, 2009, regarding File Number SR-NYSEArca-2009-44; Letter by Christopher Nagy, Managing Director Order Routing Strategy, TD Ameritrade, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 17, 2009 regarding File Numbers SR-NYSEArca-2009-44, SR-CBOE-2009-31, and SR-ISE-2009-32; Letter by John Ingrilli, Managing Director, Gerard Satur, Managing Director, and Karen Wendell, Managing Director, UBS, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 30, 2009, regarding File Numbers SR-NYSEArca-2009-44, SR-CBOE-2009-31, and SR-ISE-2009-32; Letter by Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 23, 2009, regarding File Number SR-NYSEArca-2009-44; and Letter by Thomas Wittman, Vice President, NASDAQ OMX, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 12, 2009, regarding File Numbers SR-NYSEArca-2009-44, SR-CBOE-2009-31, and SR-ISE-2009-32.

- Retention of the Traditional $3 Inflection Point;
- Growth in Quote Traffic;
- Trading All Series of Certain ETF Options in Pennies;
- Delay of the Proposed Expansion Until Approval of the Distributive Linkage Plan; and
- Adoption of a Uniform Program.

The Exchange hereby reiterates its strong support for the extension and expansion of the Penny Pilot. The Exchange believes that the Penny Pilot offers many benefits to the investing public, including increased transparency, improved price discovery, and reduced spreads. Moreover, the Commenters have largely failed to articulate concerns that warrant limiting the Penny Pilot or expanding in a manner other than as proposed by NYSE Arca.

Appropriate Scope of the Proposed Expansion

NYSE Arca proposes to expand the Penny Pilot to include the next Top 300 most actively traded multiply listed options, as measured by industry volume. This number is in addition to the securities that are already within the Penny Pilot. The Exchange believes that its proposal strikes an appropriate balance and establishes the proper scope and scale of a program designed to maximize the benefits of penny pricing to the investing public while limiting the burden to firms, vendors and exchanges of increased quote traffic. An analysis of volume among the over 2,000 options that are currently traded across the industry indicates that approximately 85% of the industry volume is concentrated in the Top 350 options. By limiting the expansion of the Penny Pilot to the next Top 300 options, the industry is insulated from the burdens of the heightened quoting activity (without meaningful trading volume) associated with the inclusion of all optionable securities.

In contrast, the CBOE proposes to expand the Penny Pilot to include all equity and ETF option classes (approximately 2,475 classes), with a six month roll-out period.[2] Adopting the CBOE's proposal would generate significantly increased quoting activity without a corresponding increase in benefits to the investing public, since the increased quote traffic would be in the less frequently traded options classes. Increasing the burden upon system

[2] *See* pages 3-4 of the Letter by Edward J. Joyce, CBOE, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 12, 2009, regarding File Number SR-NYSEArca-2009-44.

capacity without any corresponding benefit to the investment public is not a program the Commission should endorse. Instead, cognizant of the cost and impact on systems capacity, NYSE Arca's proposal offers a more appropriate expansion, tailored to the trading patters and needs of the investing public. The Exchange seeks to limit the growth of quote traffic by expanding in a more limited manner so that investors may reap the benefits of tighter spreads in the classes they are actually likely to trade while at the same time excluding securities whose inclusion in the Penny Pilot would generate little else besides quote traffic. Also, it is prudent to limit the expansion in he manner proposed by the Exchange so that the Commission, the other options exchanges, and the industry in general, may continue to monitor and assess the impact of the Penny Pilot.

Other of the Commenters suggest that expanding the Penny Pilot to the Top 363 options classes will foster unnecessary investor confusion.[3] This suggestion fails even the lightest scrutiny. The industry has already witnessed the existing Penny Pilot phase-in additional securities – much in the same manner in which we are proposing to phase-in 75 new securities each quarter until the next Top 300 names are included in the Penny Pilot. The phased approach worked well for the initial phases of the Penny Pilot and there is no reason to believe it would not work well for any subsequent expansion of the Penny Pilot, much less cause any investor confusion.[4]

<u>Exclusion of High Priced Or High Premium Underlying Securities</u>

When contemplating the initial introduction of the Penny Pilot, the industry as a whole made a conscious decision to keep high priced or high premium underlying securities out of the program,[5] and consistent with that approach, NYSE Arca's proposal retains that structure. Despite comments received, the CBOE's in particular, NYSE Arca continues to believe that it is appropriate to exclude high priced underlying equity securities, as the benefit to the public

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[3] *See* Letter by Anthony J. Saliba, Chief Executive Officer, LiquidPoint, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 17, 2009, regarding File Number SR-NYSEArca-2009-44.

[4] Moreover, the proposed expansion, which offers both a multiple phase structure and a reasonable replacement mechanism, is less confusing and more transparent than other existing industry programs. For example, the $1 and $2 ½ Dollar Strike programs create different strike price intervals for securities that are selected for participation in the programs, without any quantifiable, publicly available criteria such as we have proposed for maintaining the Penny Pilot.

[5] At the time of the last expansion of the Penny Pilot, options on Google Inc. (GOOG) were among the most actively traded; GOOG options were deliberately passed over in the expansion because of the perception that the cost of greater quote traffic outweighed any benefit from tighter spreads.

from including such issues is minimal because of the high price of at-the-money options.[6] The Exchange believes an appropriate threshold for designation as "high priced" at the time of selection of new issues to be included in the Pilot is $200 per share. At $200 per share, strike prices are in $10 increments, so the "at the money" strike is more likely to carry an intrinsic value of $3 or more, and thus not trade in a penny increment. With a greater distance between strikes, there are fewer series that are actively traded.

The Exchange would not exclude index options with an underlying index above 200; such index products often have a related ETF security that may be in the Pilot.[7] The Exchange believes related instruments should trade in the same increment if otherwise qualified.

Retention of the Traditional $3 Inflection Point

Alternative proposals filed by both the CBOE and the ISE have proposed setting a new inflection point at a premium of $1 for purposes of establishing option Minimum Price Variations ("MPV's").[8] These proposals will result in unnecessary investor confusion and will require extensive re-education of public customers, who are familiar with the traditional $3 inflection point. If implemented, such changes would also require re-programming and testing of the systems of all market participants. Retention of the traditional $3 inflection point, on the other hand, is reasonable, fosters continuity amongst markets, and is based on longstanding industry practice.[9]

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[6] For instance, as of August 12, 2009, the near term at the money call in GOOG (August 460 Calls) was trading at $6.50 with the underlying at $459.84. The lowest strike price September call trading below $3 (with the underlying at the same price) was the September 500 Call.

[7] For instance, the iShares Russell 2000 Index Fund (IWM) is in the Pilot, and the Exchange would not exclude the Russell 2000 Index (RUT), as both classes often trade as alternatives to each other. On August 18, 2009, RUT was calculated at 556.39, while IWM was trading at $55.68.

[8] *See* pages 3-4 of the Letter by Edward J. Joyce, CBOE, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 12, 2009, regarding File Number SR-NYSEArca-2009-44; See page 4 of the Letter by Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 23, 2009, regarding File Number SR-NYSEArca-2009-44 (proposing a three-tiered pricing approach with an additional inflection point at $3). See also, page 4 of the Letter by Anthony J. Saliba, Chief Executive Officer, LiquidPoint, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 17, 2009, regarding File Number SR-NYSEArca-2009-44.

[9] NYSE Arca notes that it had proposed a change in the inflection point to $5 in its original proposal to trade options in pennies in June 2005. At that time, most industry participants argued that any change in the inflection point would be too confusing to investors.

The main argument raised in support of reducing the breakpoint from $3 to $1 concerns preserving liquidity in the marketplace for institutional investors while also reducing quote traffic. Commenters have stated that there is a limited benefit to public customers in the range of $1 - $3 due to lower participation rates among retail investors at those price points. However, the statistics underscoring this argument indicate that the volume in this range attributable to public customer trading interest varied between 30% and 40%.[10] As the TD Ameritrade letter points out, fully one-third of TD Ameritrade's executions (and almost 30% of its volume) occur at this premium level. The Exchange believes providing reduced spreads to 30% of the volume to be significant, and not "limited".

NYSE Arca notes that under the current Penny Pilot, well over 90% of customer orders are filled at the top of book. The reduction in the top of book size is not to be ignored however. In the absence of other tools for getting large sized orders executed, NYSE Arca would agree that the reduced size could become problematic for larger investors. However there are tools that already exist in the marketplace such as electronic and outcry solicitation and facilitation trading mechanisms. Additionally, the soon to be launched Distributive Linkage will incorporate a new Intermarket Sweep Order ("ISO") that will allow broker dealers to simultaneously print a trade at a price inferior to the NBBO while taking out the top of the book on all exchanges. This new ISO order type will allow block sized liquidity to be sourced at prices inferior to the NBBO and let it trade, offering institutional investors the certainty of both trade and price that they need and desire. NYSE Arca feels that the current mechanisms for sourcing block sized liquidity will continue to grow and evolve to meet the demands of users and contends that reduced size at the top of the book is not a valid reason for moving the breakpoint from $3 to $1. NYSE Arca does however recognize that in the absence of the ISO order type it may become problematic to trade and print block sized orders therefore in our amended filing we will incorporate a revision to our planned roll out schedule that allows for the launch of Distributive Linkage prior to an expansion of the Penny Pilot.

Growth in Quote Traffic

The CBOE, and SIFMA in support of the CBOE proposal, argues that the cost of increased quoting outweighs the benefit of reduced spreads. This argument fails on two points. First, NYSE Arca's proposal limits the Penny Pilot's expansion to the Top 300 options, which together with the existing classes, account for 85% of the total marketplace volume – thereby offering the benefits of the Penny Pilot (increased transparency and reduced spreads) to investors on the options they actually trade. The remaining 15% (over 1700 options) are not

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[10] Glaringly, the CBOE and the ISE fail to outline a strategy for rolling back series from a penny increment trading under the current structure of the Penny Pilot to a wider MPV. The Exchange believes that this roll-back feature needlessly exposes investors to increased exposure and risk.

scheduled for inclusion and thus systems will not be unnecessarily burdened by increased quote traffic in those lightly traded classes. Second, the benefit of the reduced spread falls on the customer, while the cost of increased quote traffic falls to firms, exchanges, and vendors. While the Exchange recognizes the need for responsible quote mitigation, there has been no outcry from vendors or firms in response to quote traffic projections through mid-year 2011, as published by the Options Price Reporting Authority ("OPRA").[11] Further, the Exchange represents that it will retain, and continue to employ, its quote mitigation strategy.

Trading All Series of Certain ETF Options in Pennies

The Exchange has proposed expanding the number of ETF options that trade in all pennies to include options on SPDR S&P 500 ETF ("SPY") and the iShares Russell 2000 Index Fund (IWM). CBOE has commented on the lack of empirical evidence to demonstrate the benefit for this change. We note that the benefits in reduced spreads in all series for QQQQ indicate that options on highly liquid ETFs are well suited to trade in penny increments, and that a reasoned, limited expansion of this aspect of the Penny Pilot will provide sufficient data to demonstrate its value to the investing public.

The Exchange also notes that the NASDAQ Options Market ("NOM") has seen a demonstrable benefit to customers by allowing the entry of penny denominated orders in Penny Pilot series trading above $3.[12] Indeed, in SPY, NOM saw 35% of the orders receive price improvement, with an average savings of $2.36. The Exchange believes if this benefit were subject to open and transparent intermarket competition, under the structure of the Penny Pilot, the benefits to customers would be even greater.

The success of both NOM's Price Improving orders and the BOX Price Improvement Period ("PIP")[13] show that there is significant customer interest in trading as many options series as possible in penny increments.[14]

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[11] The Exchange further notes that much of the growth in quote traffic over the last year is because of the tremendous increase in the number of series listed, reflecting a roughly 50% movement in the Dow Jones Industrial Average and the Standard and Poor's 500 Index over the period from late April 2008 to early March 2009.

[12] NOM Press Release, dated July 10, 2009.

[13] BOX website advertises an average savings of $3 per contract on Customer marketable orders submitted to the PIP.

[14] Unfortunately, neither CBOE (with its Auction Improvement Mechanism), nor the ISE (with its Price Improvement Mechanism) publish statistics on the savings to customers.

Adoption of a Uniform Program

The Exchange agrees with the various comments[15] that cite the likelihood of increased investor confusion should more than one proposal be approved by the Commission. In comparison with the other proposals, the Exchange believes that its proposal offers the most appropriate scope and structure for the industry to follow. As designed, NYSE Arca's proposal to expand the Penny Pilot offers increased transparency and reduced spreads in the options classes of most interest to the investing public. The Exchange's proposal accomplishes these goals with limited burden upon quote capacity bandwidth and without unnecessarily increasing investor confusion.

Conclusion

Expanding the Penny Pilot, as proposed by NYSE Arca, to include the next Top 300 options by industry volume, while utilizing the traditional $3 inflection point, offers several benefits to the investing public, including:

- *Enhanced Transparency.* NYSE Arca's proposal enhances transparency by enabling explicit penny quoting and trading for all investors as opposed to less transparent private price improvement auctions and/or dark penny quoting and trading;

- *Bandwidth Protection.* In recognition of the enhanced bandwidth required for quoting the additional classes identified for inclusion, NYSE Arca limited expansion to the classes that actually trade – thereby offering the greatest amount of benefit to the investing public without unduly burdening systems with increased quote traffic in lightly traded classes; and

- *Flexibility within a Structured Roll-Out.* Expanding the Penny Pilot by just the Top 300 names via a transparent, phased approach enables the industry greater flexibility in managing the Penny Pilot and monitoring its impact on the market.

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[15] *See* page 4 of the Letter by Edward J. Joyce, CBOE, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 12, 2009, regarding File Number SR-NYSEArca-2009-44; pages 5-6 of the Letter by Thomas F. Price, Managing Director, SIFMA, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 17, 2009, regarding File Numbers SR-NYSEArca-2009-44, SR-CBOE-2009-31, and SR-ISE-2009-32; page 2 of the Letter by Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 23, 2009, regarding File Number SR-NYSEArca-2009-44 (proposing a three-tiered pricing approach with an additional inflection point at $3); and page 2 of the Letter by Anthony J. Saliba, Chief Executive Officer, LiquidPoint, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 17, 2009, regarding File Number SR-NYSEArca-2009-44..

We look forward to approval of our filing. Additional comments or questions may be directed to Edward Boyle (312) 442-7662, Andrew Stevens (312) 442-7632, or Peter Armstrong (415) 393-4232.

Sincerely,

Janet M Kissane

cc: Elizabeth King
Heather Seidel
Jennifer Colihan