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VIA FEDERAL EXPRESS

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

Re: Exemptive Application Pursuant to Rule 612(c) of Regulation NMS – NYSE and NYSE Amex Proposed Retail Liquidity Program

Dear Ms. Murphy:

Pursuant to Rule 612(c) of Regulation NMS under the Securities Exchange Act of 1934 ("the Exchange Act"), NYSE LLC ("NYSE") and NYSE Amex LLC ("NYSE Amex," collectively with NYSE, the "Exchanges") request that the Securities and Exchange Commission ("the Commission") exempt the Exchanges and Retail Price Improvement Orders ("RPI") entered under NYSE's and NYSE Amex's proposed Retail Liquidity Program ("the Program")[1] from the provisions of Rule 612 ("the Sub-Penny Rule" or "the Rule") that prohibit a national securities exchange from accepting or ranking certain orders based on an increment smaller than the minimum pricing increment. We believe the Program has the potential to offer superior execution prices to retail investors and to encourage price competition for retail orders among liquidity providers under the Program. Further, the non-displayed RPIs would not implicate any of the concerns that the Sub-Penny Rule was designed to address. Accordingly, as set forth below, the exemption would serve to promote the public interest and protect investors.

Background to the Proposed Retail Liquidity Proposal.

The Exchanges believe that the quality of our markets and the accuracy of price discovery depend on the interaction among a diverse set of market participants, including short-term, long-term, retail and institutional investors. The interaction among these participants has become more limited under the current market structure as long-term investors execute orders in increasingly diverse execution venues. The Exchanges continue to fully embrace fair competition among exchanges and other market centers and acknowledge the positive trading

[1] The Program is contained in two proposed rules, proposed NYSE Rule 107C and proposed NYSE Amex Equities Rule 107C ("the proposed Rules"), which have been filed with the Commission concurrently with this exemptive application.

experience that retail investors enjoy in today's marketplace. At the same time, we support the Commission's efforts to examine the impact of fragmentation on market quality, price discovery and retail investor protection.[2] We also believe that the Retail Liquidity Program represents an opportunity to take an important step in the direction of greater price competition for retail orders.

The Proposed Retail Liquidity Program.

Participants, Incentives and Order Types. The Exchanges have filed proposed rule changes with the Commission to establish a Retail Liquidity Program on a pilot basis[3] to attract additional retail order flow to the Exchanges for NYSE-listed and NYSE Amex Equities traded securities.[4] At the core of the Program are two new classes of market participants utilizing two new order types (Retail Orders and RPIs).

- ***Retail Member Organization*** ("RMO"). An RMO is a member organization approved by the Exchanges[5] to submit Retail Orders pursuant to the Program. To qualify as an RMO, a member must conduct a retail business or handle retail orders on behalf of another broker-dealer. An RMO must submit an attestation that any order it submits will qualify as a Retail Order and provide supporting documentation sufficient to demonstrate the retail nature and characteristics of the applicant's order flow. The Exchanges may disqualify an RMO for submitting orders designated as Retail Orders that fail to meet the requirements of the Program, subject to the process set forth in the proposed Rules. In exchange for submitting Retail Orders through the Program, an RMO will receive a credit.

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2 *See* Speech by Chairman Mary L. Shapiro "*Strengthening Our Equity Market Structure,*" September 7, 2010 referencing reports of retail broker-dealers that individual investors have retreated from the equity markets since May 6, 2010 and mutual fund data reflecting a pattern of an outflow of funds from equity mutual funds since the events of that day.

3 The proposed pilot period would extend twelve months from the date of implementation of the Program, which would occur no later than 90 days after Commission approval of NYSE and NYSE Amex Equities Rule 107C. The Program would expire on a date to be determined upon adoption of the proposed Rules.

4 "NYSE Amex Equities traded securities" refers to all securities available to be traded on NYSE Amex Equities, including but not limited to NYSE Amex-listed securities as well as those listed on the Nasdaq Stock Market traded pursuant to unlisted trading privileges. *See* Exchange Act Release 34-62479, 75 Fed. Reg. 41264 (July 15, 2010).

5 This application often refers collectively to NYSE and NYSE Amex and discusses proposed NYSE Rule 107C and proposed NYSE Amex Equities Rule 107C together. NYSE and NYSE Amex Equities operate on the same trading platform with similar rules, and pursuant to NYSE Rule 2.10 and NYSE Amex Equities Rule 2.10, all member organizations of NYSE are deemed member organizations of NYSE Amex Equities, and vice versa. Accordingly, if a member organization qualifies under one of the proposed Rules, it will automatically qualify under the other proposed Rule. Where the proposed Rules diverge is that proposed NYSE Rule 107C relates to quoting obligations in NYSE-listed securities, and proposed NYSE Amex Equities Rule 107C relates to quoting obligations in NYSE Amex Equities traded securities.

- ***Retail Order.*** A Retail Order is (1) an agency order originating with a natural person, submitted by the RMO pursuant to the Program without modification with respect to price or side of market, and not generated by a trading algorithm or other computerized methodology, or (2) a proprietary order of an RMO that results from liquidating a position acquired from the internalization of such agency orders. Retail Orders are by definition Immediate or Cancel ("IOC") orders that may interact, in accordance with the RMO's instructions, with (1) liquidity in the Program, (2) other interest in NYSE and NYSE Amex systems, and (3) liquidity residing on away markets.

- ***Retail Liquidity Provider*** ("RLP"). 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 using RPIs. The currently specified minimum price improvement is $0.001 per share. To qualify as an RLP, a member must be approved to act as a Designated Market Maker or Supplemental Liquidity Provider, meet certain clearing and other requirements, and have adequate trading infrastructure, technology, and support. The Exchanges may approve one or more RLPs for a particular security. An RLP may enter RPIs only for securities to which it is assigned. An RLP agrees to maintain electronic RPIs directly in NYSE or NYSE Amex systems for a minimum percentage (5%) of the trading day for securities to which it is assigned. The Exchanges may revoke assignments of securities to RLPs or disqualify RLPs for failure to maintain RPIs for the required duration, subject to the process set forth in the proposed Rules. An RLP may also act as an RMO for securities to which it is not assigned, subject to the qualification and approval process established by the proposed Rules. In exchange for satisfying its obligations to maintain RPIs electronically in NYSE or NYSE Amex systems for the required percentage of the trading day, RLPs are offered a pricing advantage in relation to non-RLPs.

- ***Retail Price Improvement Order.*** An RPI consists of non-displayed interest in NYSE-listed or NYSE Amex Equities traded securities that is: better than the Protected Best Bid ("PBB") or Protected Best Offer ("PBO") by at least $0.001, entered electronically into NYSE or NYSE Amex systems, and available to interact automatically with Retail Orders entered by an RMO.[6] An RPI may be entered by an RLP or a non-RLP member organization.

Retail Order Designations. An RMO can designate how a Retail Order would interact with available contra-side interest as follows. As proposed, a Type 1-designated Retail Order would interact only with available contra-side RPIs and would not interact with other available contra-side interest in NYSE or NYSE Amex systems or route to other markets.

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[6] The Exchange recognizes that sub-penny trading and pricing could potentially result in undesirable market behavior. The Exchange will monitor the Program in an effort to identify and address any such behavior.

The portion of a Type 1-designated Retail Order that does not execute against contra-side RPIs would be immediately and automatically cancelled. A Type 2-designated Retail Order would interact first with available contra-side RPIs and any remaining portion of the Retail Order would be executed as a Regulation NMS-compliant Immediate or Cancel Order pursuant to NYSE or NYSE Amex Equities Rule 13. Accordingly, a Type 2-designated Retail Order could interact with other interest in NYSE or NYSE Amex systems, but would not route to other markets. A Type 3-designated Retail Order would interact first with available contra-side RPIs and any remaining portion of the Retail Order would be executed as an NYSE Immediate or Cancel Order or an Exchange Immediate or Cancel Order pursuant to NYSE or NYSE Amex Equities Rule 13. A Type 3-designated Retail Order therefore could interact with other interest in NYSE or NYSE Amex systems and, if necessary, would route to other markets in compliance with Regulation NMS.

Retail Liquidity Identifier. The Exchanges propose to disseminate an identifier through proprietary data feeds when RPI interest priced at least $0.001 better than the PBB or PBO for a particular security is available in NYSE or NYSE Amex systems ("Retail Liquidity Identifier"). The Retail Liquidity Identifier would not be disseminated to the Consolidated Quote Stream.

Priority and Order Allocation. The priority and order allocation of the Program will operate as follows. The price of an RPI would be determined by an RLP's entry of the following into NYSE or NYSE Amex systems: (1) RPI sell or buy interest; (2) an offset, if any; and (3) a floor or ceiling price. The Exchanges expect that RPI sell or buy interest typically would be entered to track the PBBO. The offset would be a predetermined amount by which the RLP is willing to improve the PBBO, subject to a floor or ceiling price. The floor or ceiling price would be the amount below or above which the RLP does not wish to trade. The combination of RPI buy or sell interest, offset, and ceiling or floor will in effect form a non-displayed book of RPIs that are ranked and executed according to price-time priority. All RPIs will be automatically executable. Incoming Retail Orders will execute at the price of the last RPI required (or available) to satisfy the Retail Order.

Priority, Ranking and Allocation Example. The Exchanges propose that competing Retail Price Improvement Orders in the same security be ranked and allocated according to price then time of entry into NYSE and NYSE Amex systems. The Exchanges further propose that executions occur at the price level that completes the incoming order's execution. Any remaining unexecuted RPI interest will remain available to interact with other incoming Retail Orders if such interest is at an eligible price. Any remaining unexecuted portion of the Retail Order will cancel or execute in accordance with proposed NYSE and NYSE Amex Equities Rule 107C(k). The following example illustrates this proposed method:

PBBO for security ABC is $10.00 – $10.05

RLP 1 enters a Retail Price Improvement Order to buy ABC at $10.01 for 500
RLP 2 then enters a Retail Price Improvement Order to buy ABC at $10.02 for 500
RLP 3 then enters a Retail Price Improvement Order to buy ABC at $10.03 for 500

> An incoming Retail Order to sell ABC for 1,000 would execute first against RLP 3's bid for 500, because it is the best priced bid, then against RLP 2's bid for 500, because it is the next best priced bid. RLP 1 would not be filled because the entire size of the Retail Order to sell 1,000 would be depleted. The Retail Order executes at the price that completes the order's execution. In this example the entire 1,000 order to sell would execute at $10.02 because it would result in a complete fill.
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> However, assume the same facts above, except that RLP 2's Retail Price Improvement Order to buy ABC at $10.02 was for 100. The incoming Retail Order to sell 1,000 would execute first against RLP 3's bid for 500, because it is the best priced bid, then against RLP 2's bid for 100, because it is the next best priced bid. RLP 1 would then receive an execution for 400 of its bid for 500, at which point the entire size of the Retail Order to sell 1,000 would be depleted. The Retail Order executes at the price that completes the order's execution, which is $10.01.

The Sub-Penny Rule Was Designed to Deal with Concerns Related to Public Display or Private Communication of Quotes in Sub-Penny Increments, Concerns Which Are Not Implicated by the Retail Liquidity Program's Non-Displayed RPIs.

The Sub-Penny Rule establishes a minimum pricing increment for NMS stocks providing in pertinent part that national securities exchanges, ATSs, vendors, brokers and dealers shall not display, rank, or accept from any person a bid or offer, an order, or an indication of interest in any NMS stock priced in an increment smaller than $0.01 if that bid or offer, order, or indication of interest is priced equal to or greater than $1.00 per share.[7]

The Rule similarly establishes a minimum increment of $0.0001 for orders priced less than $1.00 per share.[8]

The Rule further provides that the Commission may, by order, exempt

> any person, security, quotation, or order, or any class or classes of orders of persons, securities, quotations, or orders, if the Commission determines that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.[9]

At the core of the Rule's purpose was the Commission's concern with the potential of sub-penny increments to erode the incentives of investors to display limit orders. The Commission proposed the Rule in an effort to "limit the ability of a market participant to gain

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[7] Rule 612(a) of Regulation NMS.

[8] Rule 612(b) of Regulation NMS.

[9] Rule 612(c) of Regulation NMS.

execution priority over a competing limit order by stepping ahead by an economically insignificant amount."[10]

Among the related concerns associated with sub-penny quoting referenced by the Commission in adopting the Sub-Penny Rule were: (1) the possible decrease in market liquidity attributable to a reduced use of limit orders by investors; (2) the erosion of customer protections such as exchange priority rules and Manning where market participants could gain execution priority over a limit order for an "infinitesimally small" increment[11]; (3) flickering quotations resulting from widespread sub-penny pricing and attendant best execution concerns; (4) a potential decrease in market depth at the inside; and (5) potentially increased incentives on the part of institutions, given reduced depth at the inside, to rely on execution alternatives "away from the exchanges and Nasdaq" and the increased fragmentation that such incentives could drive.[12]

Importantly, both the core concern the Sub-Penny Rule sought to address – the displayed limit order's loss of priority to an insignificantly better price – and the additional concerns related to liquidity, best execution, capacity, and fragmentation relate to *sub-penny quoting and not sub-penny trading*. The Commission drew the distinction plainly in the Adopting Release and went on to flag the particular benefit of sub-penny executions to retail investors:

> The Commission believes at this time that trading in sub-penny increments does not raise the same concerns as sub-penny quoting. Sub-penny executions do not cause quote flickering and do not decrease depth at the inside quotation. Nor do they require the same systems capacity as would sub-penny quoting. In

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10 Securities Exchange Act Release No. 34-51808, 70 Fed. Reg. 37496, 37551 (June 29, 2005) ("NMS Adopting Release").

11 It is important to view the Commission's characterization of sub-penny increments as economically insignificant as tied closely to the particular systemic benefits that displayed limit orders bring to price competition. "[T]he Commission agrees with the many commenters who believed that prohibiting sub-penny quoting would deter the practice of stepping ahead of exposed trading interest by an economically insignificant amount. Limit orders provide liquidity to the market and perform an important price-setting function. If a quotation or order can lose execution priority because of economically insignificant price improvement from a later-arriving quotation or order, liquidity could diminish and some market participants could incur greater execution costs." NMS Adopting Release at 37588. In other words, the increment was seen as trivial in relation to the important systemic risks it presented. It was price competition driven by *displayed, exposed* orders that concerned the Commission, not undisplayed orders like the RPIs. Moreover, the Commission did not view the price improvement produced as a result of sub-penny executions as trivial. Rather, the language quoted infra at page 6 from the Adopting Release makes clear that the Commission recognized sub-penny executions as "generally beneficial." In any event, the Exchanges believe that the minimum price improvement available under the Program, which would amount to $0.05 on a 500 share order, would be meaningful to the small retail investor.

12 NMS Adopting Release at 37551-52.

> addition, sub-penny executions due to price improvement are generally beneficial to retail investors.[13]

Pursuant to the Retail Liquidity Program, neither Retail Orders nor RPIs will be displayed by the Exchanges. Retail Orders by definition will be IOC orders. RPIs are defined as consisting of "non-displayed interest that is better than the best protected bid" by proposed NYSE and NYSE Amex Equities Rule 107C (a)(3) and (4).[14] Accordingly, the nature of the proposed order types simply does not give rise to the concerns addressed by the Sub-Penny Rule. There would be no potential for them to step ahead of any displayed order, to jeopardize the incentives to place limit orders, or to otherwise implicate the customer protection, capacity, best execution, liquidity and fragmentation concerns addressed by the Sub-Penny Rule. In addition, the Program would actually serve to *encourage* the additional display of liquidity in the marketplace and would not detract from the quality of orders in the marketplace as raised in Regulation NMS.

Similarly, while the Exchanges would "accept" and "rank" non-displayed RPIs using increments less than the minimum pricing increment as described above, doing so would in no way undermine the purpose or framework of the Sub-Penny Rule. Indeed, the prohibition on the acceptance and ranking based on sub-pennies was directed at the practice of private sub-penny display that had developed on ECNs in the wake of decimalization.[15] Some ECNs during that period were accepting, ranking and privately displaying sub-penny orders to subscribers while at the same time (then pre-exchange) Nasdaq and the exchanges were requiring their members to quote in pennies and the public quote stream reflected those quotes only in pennies. The Commission expressed concern that this lack of uniformity was "creating hidden markets whereby sophisticated traders [could] view and access better prices than those available to the general public."[16] The Sub-Penny Rule's prohibition on accepting and ranking sub-penny orders is therefore best understood as an effort to address and prevent the development of private or hidden markets with better-priced sub-penny orders. Because the RPIs would remain at all times entirely non-displayed, they present no risk that a hidden sub-penny market would develop. Rather, the whole point of the Retail Liquidity Program is *to make better prices available to the general public by fostering competition on public markets for retail orders.*

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13 NMS Adopting Release at 37556.

14 RPIs in their entirety (buy or sell interest, any offset, and the ceiling or floor) will remain undisplayed.

15 Securities Exchange Act Release No. 34-49325, 69 Fed. Reg. 11126, 11163-64 (Mar. 9, 2004) ("NMS Proposing Release"). The Commission noted the "growing trend in the industry, particularly among ECNs, to display quotations in their proprietary systems in sub-pennies . . . ." Proposing Release at 11163.

16 NMS Proposal at 11171.

The Proposed Exemption Would Serve to Protect Investors and Otherwise Serve the Public Interest Because It Would Enhance Price Competition for Retail Orders And Would Offer A More Robust Regulatory and Surveillance Environment for the Execution of Retail Order Flow.

The Retail Liquidity Program Would Enhance Price Competition for Retail Orders. The potential for enhanced price competition would be created by the following incentives. Members would be attracted to become RLPs because they could (1) interact with retail order flow in an exchange environment; and (2) enjoy a significant pricing advantage in relation to non-RLPs to the extent they had the capability to meet the RLP obligation and they viewed there to be an adequate cost and benefit tradeoff between the obligation and rewards.

Member organizations handling retail flow would have an incentive to become RMOs because of (1) the presence of multiple RLPs and non-RLPs competing on the basis of price improvement to execute their customers' orders; (2) the economic benefit of the per share credit offered under the Program; and (3) the likely increased comfort that the Exchanges' operation and regulation would provide RMOs with respect to best execution.

The most aggressive RLPs and non-RLPs in terms of price improvement would be rewarded with executions under the Program. RMOs, if price competition for Retail Orders developed as expected, would see the benefit of the increased competition in execution prices they reported back to their customers. The improved effective spreads would be marketed by the Exchanges and in any supplemental voluntary effective spread data provided by RLPs to RMOs. Individual investors would benefit directly from any improvement in execution prices that the enhanced competition produced.

The Retail Liquidity Program Has the Potential to Increase the Level of Interaction Experienced by Retail Orders. To be sure, the growth of nontransparent liquidity is not simply a market structure issue for the Exchanges but a competitive challenge as well. The segmentation of differing order flows by non-exchange venues in particular has presented the Commission for more than a decade with the difficult tension between promoting market center competition on the one hand and promoting order interaction on the other. Clearly, the Retail Liquidity Program is part of the Exchanges' efforts to compete as a market center for the retail order flow that is being internalized away from the Exchanges. The Program should also be understood, however, to offer the collateral benefit of improving the order interaction that retail executions experience.

The potential gains in order interaction under the program are three. First, multiple RLPs typically will be able to interact with every Retail Order directed by an RMO under the Program. Second, any non-RLP member organization will be able to submit RPIs under the Program, and the Exchanges believe these interactions will bring together market participants who otherwise may have not been able to interact. Third, Retail Orders under the Program will be able to interact with the displayed interest on the NYSE or NYSE Amex where there is no RLP or non-RLP liquidity available. To the extent that RMOs utilize the retail order designations allowing them to check for displayed NYSE or NYSE Amex liquidity after finding no liquidity in the Program, the functionality would represent a further advance for potential interaction with retail orders.

The Liquidity Maintenance Obligations of the Retail Liquidity Program Offer a Framework for More Stable Liquidity Provision to Retail Orders. No NYSE or NYSE Amex program or incentive can promise the delivery of liquidity in times of extreme market stress. However, we share the concern that the events of May 6, 2010, which led to the rapid removal of liquidity, an absurd level of price dislocations, and thousands of broken trades, have shaken the confidence of the retail investor. The Exchanges believe that the liquidity maintenance obligations of the Program offer a framework for a more stable provision of liquidity to retail investors. In particular, the five-percent maintenance obligation together with the multiple-RLP model have the potential to create durable pockets of retail liquidity that beget further liquidity that might not develop absent a catalyst.

The Exchange Offers a Robust Regulatory and Surveillance Alternative to the Existing Oversight of Internalization. The Exchange has been clear in recognizing that internalization has resulted in positive trading experiences for retail investors. At the same time, we have pointed out our reservations about the current regulatory disparities between registered exchanges on the one hand and ATSs, dark pools, and broker-dealer internalization venues on the other. The current Retail Liquidity Program proposal illustrates what we believe to be a fair balance for the various market participants. The Program recognizes the economic reality of the short-term profit potential on retail orders from the reduced sensitivity of the typical retail investor to short-term price movements. Accordingly, the Program is premised upon the reliable identification and segmentation of retail flow. The Program has been designed, however, to simultaneously produce aggressive price competition and as much order interaction for the Retail Order as possible.

It is worth underscoring that *every* significant aspect of the Program, including the minimum level of required price improvement and the details of the liquidity maintenance obligations, will be publicly exposed through a rule filing, commented on by any market participant or member of the public who cares to comment, and examined closely by the staff. It will be implemented only if and when approved by the Commission. The credits paid to RMOs and the fees to be charged to RLPs will be subject to the Commission's rule filing process. In addition, the Exchanges will be obligated to ensure that access to the Program is granted on terms that do not permit unfair discrimination. Finally, the trading activity conducted through the Program will be subject to extensive market surveillance pursuant to the Exchanges' obligations as self-regulatory organizations. These are all improvements to the current execution landscape. The Retail Liquidity Program therefore offers a distinct advance in the transparency of current internalization arrangements and the quality of the regulatory effort directed at them.

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No single proposal can reasonably claim to address the myriad of complex challenges associated with the segmentation of retail order flow. That said, the Exchanges believe that the Retail Liquidity Program has the potential to be an important competitive first step in the direction of more vibrant price competition for retail flow, a higher degree of order interaction between market participants than occurs today, and the provision of more reliable liquidity. These potential benefits, along with the attraction of internalized liquidity to market centers with greater transparency around their processes and a more robust regulatory framework, are well worth seeking if they contribute even modestly to the confidence of the individual investor in the operation of the equity markets and their pricing mechanism.

For the reasons set forth above, the Exchanges respectfully request an exemption from NMS Rule 612 for the Exchanges and RPIs entered, accepted, and ranked pursuant to the proposed Retail Liquidity Program set forth in proposed NYSE Rule 107C and proposed NYSE Amex Equities Rule 107C because the Program would serve the public interest and otherwise protect investors.

Thank you in advance for your consideration of this request.

Sincerely,

Janet McGinness