April 30, 2010

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

RE: Petition requesting the Commission exercise its exemptive authority under Rule 612(c) of Regulation NMS to approve a six-month pilot program permitting market participants to display, rank, and accept sub-penny quotes and orders in securities priced between $1.00 and $20.00, including a single ETF (QQQQ) trading at greater than $20.00.

Dear Ms. Murphy:

BATS Exchange, Inc., NASDAQ OMX Group, Inc., and NYSE Euronext, Inc. ("Petitioners") respectfully request that the Commission exercise its exemptive authority under Rule 612(c) of Regulation NMS and approve the implementation of a pilot program to permit market participants to display, rank, or accept from any person a bid or offer or order in a minimum price variation ("MPV") smaller than $0.01 ("sub-penny quoting"). As explained herein, the Petitioners believe that the imposition of an MPV of $0.01 has resulted in a publicly displayed quote that is artificially wide for certain lower priced, liquid securities, and has caused a detrimental impact to the public price discovery process, resulting in worse execution prices for investors. Consequently, the Petitioners respectfully request that the Commission approve the implementation of a six-month pilot program to permit sub-penny quoting at an MPV of $0.005 (½ cent) in certain select securities generally trading at prices between $1.00 and $20.00, including a single ETF (QQQQ) trading at greater than $20.00.

Rule 612(a) of Regulation NMS currently prohibits market participants from sub-penny quoting in securities priced equal to or greater than $1. Rule 612(c) of Regulation NMS further explicitly provides the Commission broad authority to issue an order exempting from this restriction "any person, security, quotation, or order, or any class or classes 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." The Commission discussed in the order adopting Regulation NMS the circumstances under which the Commission might exercise this exemptive authority. In so doing, the Commission stated that: "[i]f a security always trades with a penny spread and there is tremendous liquidity available on both sides of the market this is a strong indication that the minimum increment is too wide."[1] The Commission further referenced the following non-exclusive additional factors it might consider in exercising the exemptive authority:

- whether the security is an ETF or other derivative for which the true value of the security as derived from its underlying components might be at a sub-penny increment;

- whether there are a large volume of sub-penny executions in the security occurring between the quoted spread; and

- whether the security is trading at a low price.[2]

<u>Evidence that a one cent minimum quote increment impedes price discovery subjecting investors to additional costs</u>

Data indicate that a one cent MPV is artificially wide. Specifically, a disproportionately high percentage of transactions in securities priced between $1 and $20 dollars are occurring away from lit markets, which we believe indicates a lack of quote competition. In addition, alarge percentage of share volume transacting in securities priced below $20 is occurring in securities that are routinely quoted at the MPV, indicating a likelihood that price discovery is being constrained by the MPV. Moreover, a significant percentage of the volume in these securities (4%) is transacting at a $0.005 increment, despite the lack of public price discovery at this increment. Finally, analysis of an active security whose price transitions below and above $1 indicates investors' willingness to quote more aggressively when not constrained by the one cent MPV.

When the publicly displayed quote is held artificially wide (constrained by an MPV of $0.01), the national best bid and offer ("NBBO") are not able to approximate the best and true value of the security. As a result, the discrepancy between the security's fair value and the best bid or the best offer for the security becomes materially wide as a percentage of the price of the security. Buying well below (as a percentage of underlying price) or selling well above the fair value of a security reflects an inefficiency in the marketplace, and price formation is hampered to the detriment of the investing public (both retail and institutional).

This inefficiency and "disproportionate bid/offer spread" profit opportunity creates an incentive for substantial liquidity to be posted <u>*at the NBBO*</u> in these securities across public

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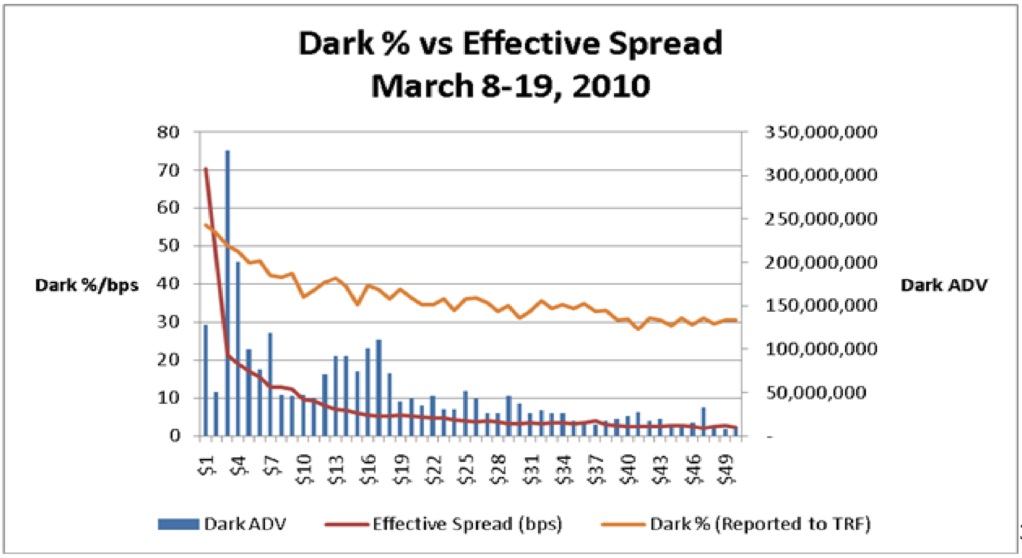
1 Exchange Act Release No. 51808 (June 9, 2005), 70 FR 124 (June 29, 2005).

2 <u>Id.</u>

markets and dark venues alike, indicating an opportunity for additional competition between the quoted spread. The Petitioners believe, however, that the inability to publicly display and rank orders between the existing MPV results in missed opportunities for investors to receive better prices. A disproportionate amount of executions in these securities occur at dark venues at or very close to the constrained NBBO.

The following chart, which graphs prices of all NMS securities against the basis point effective spread and percentage of volume trading in the dark, is illustrative:



[3]

As can be seen from the above chart, both the percentage of dark venue volume and the effective spread in basis points are disproportionately high for lower priced securities and only begin to normalize at securities priced somewhere above $20.00. The Petitioners note that at $20 the MPV is equal to 5bps. The chart above shows that as the price increases above $20, the effective spread remains at approximately 5bps of the price of the security. The Petitioners believe that this indicates that up to $20 the effective spread is being held artificially wide by the MPV while after $20 competitive forces are allowed to determine the optimal effective spread, rather than the MPV.

Further illustrative of the detrimental impact the existing MPV is causing to the public price discovery process, the following chart shows the percentage of volume traded at each price that occurs in stocks (non-ETFs) that are constrained by the MPV. A security quote constrained by the MPV is one with an average quoted spread less than or equal to 1.1 cents.

[3] The chart represents volume reported to a trade reporting facility ("TRF"), where all dark venue trades are reported. The chart does not, however, account for other non-dark volume from ECNs that are also reported to a TRF. Nonetheless, we believe the chart reflects a reasonable approximation of dark volumes and trends.

As shown by the chart, quote constrained stocks consistently represent more than 90%, sometime as much as 100%, of all traded volume at that price up to $20 in stocks that execute more than one million shares per day. Beginning at prices higher than $20, the percentage of traded volume in quote constrained securities declines precipitously. Not coincidently, this is the same price at which the effective spread from the previous chart begins to normalize. Both effective spread and quote constrained percentage of volume point to a similar conclusion: in stocks up to $20 competitive forces are not currently allowed to determine the optimal effective spread but are rather constrained by the present artificially wide MPV.

Additional evidence indicating the one cent MPV is impeding price discovery can be found in stocks that change in spread from several hundredths of a penny when the share price is below $1 to one penny when the share price moves above $1. For example, Sirius XM Radio Inc. (SIRI) is an actively traded security whose share price has fluctuated above and below $1. When the stock trades at prices between 80 cents and $1, the spread is generally one hundredth of a penny and executions occur at the spread. When the stock is trading at prices just above $1 the spread is generally one penny and the majority of executions occur at the spread, with a small percentage of executions between the spread, indicating infrequent price improvement. The spread increases approximately 100 times when the quote moves above the SEC-mandated threshold of $1.00 per share, indicating that, for such a security, the spread is artificially wide above one dollar. The artificially wide spread represents increased costs to investors.

Finer quote increments can reduce costs for investors

The Petitioners believe that introducing finer MPV increments would allow competitive market forces to reflect a better approximation of a stock's value. Displayed bids and offers would narrow inward, closer to the perceived fair value. Investors will improve the spread and provide price improvement beyond what's available in today's $0.01 MPV environment. The extra costs to investors resulting from the existing artificially wide MPV would likely evaporate as the opportunity for transparent quote competition incentivized trading participants to reflect a bid offer spread that more closely approximates the true value of the underlying security. Investors would subsequently receive better prices than they currently receive today.

As an example of how the MPV affects investor costs, consider that when an investor buys a security, the value of the investor's position is immediately reduced by the spread. If an investor buys 100 shares at $5.00 when the spread is $5.00 to $5.01, the cost of exiting the position is one dollar plus transaction costs. When the spread is one half of a penny ($5.00 to $5.005), and the investor buys 100 shares at $5.00, the cost of exiting the position is only 50 cents plus transaction costs. The benefit of a tighter spread is realized by any investor removing liquidity with a marketable limit or market order. The investor does not need to even be aware of the tighter spread to benefit.

The Petitioners believe that the thesis proposed here may be influenced by more than just the price range of securities. Other factors that may contribute to the appropriateness of finer MPVs include daily average volume (i.e. more liquid securities vs less liquid securities) as well as the nature of the security itself. For example, finer MPVs may be more appropriate for ETF securities because of the deterministic nature of their price resulting from the underlying formula of the securities that make up the ETF. The pilot study the Petitioners are proposing includes a wide range of securities exhibiting many different characteristics.

Pilot Details

The Petitioners respectfully request that the Commission exercise its authority under Rule 612(c) and approve the implementation of a six-month pilot program to allow certain securities to trade at an MPV finer than $0.01. The Petitioner's proposal consists of the following components:

- An MPV for securities included in the pilot program of $0.005 (½ cent).

- The inclusion in the pilot program of the 30 securities listed on the attached appendix. These securities were selected across a range of price points from $1.00 to $20.00, including a single ETF (QQQQ) trading at greater than $20.00, and a range of trading volumes to measure the impact of a finer MPV.[4]

- Price protection of the ½ cent MPV under Rule 611 of Regulation NMS.

- Temporary exemptive relief from the Manning rule (FINRA IM-2110-2) during the pilot program to align the MPV with the minimum amount of price improvement necessary for a member to execute an order on a proprietary basis when holding an unexecuted limit order in that security without creating an obligation to execute the held limit order.

- Optional participation in the pilot program by market participants. That is, market participants would not be required to accept orders or publish quotes at the pilot program's ½ cent MPV. However, market participants could not trade through nor lock or cross an away market's better priced ½ cent protected quote.

- No change to the access fee cap of Rule 610 of Regulation NMS for securities included in the pilot program.

- Monthly reports to the Commission by Participating Exchanges of the percentage of trading in these securities reported to the TRF and the effective spread.

- The Petitioners do not contemplate adding or removing securities from the pilot within the six month time period. If a security is delisted or otherwise ceases trading it will not be replaced with another security. If the share price of a security in the pilot rises above $20 the security will remain in the pilot. If the share price of a security in the pilot drops below one dollar the minimum quote increment will naturally revert to the current one hundredth of a penny level and if the share price subsequently rises above one dollar the $0.005 pilot quote increment will apply providing further data for stocks transitioning between the $1 share price threshold.

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4 As part of the pilot program, the Petitioners considered proposing a ½ cent tick limitation for certain sub-dollar securities as well as wider tick limitations (nickels/dimes) for certain higher priced securities. The Petitioners believe, however, at this time it makes more sense to focus this pilot on securities trading between $1 and $20 and only considering expanding or limiting the pilot program at a later date after collecting data and statistics from the pilot program being proposed.

- At the conclusion of the pilot program, and depending on the results, we would envision requesting the Commission to make the pilot program permanent for more, if not all, active securities trading between $1 and $20 and possibly some additional securities above $20. [5]

Conclusion

The Petitioners believe that exercise by the Commission of the exemptive authority contained in Rule 612(c) to implement a pilot program for the trading of certain securities at ½ cent tick increment is necessary and appropriate in the interests of public investors. As stated above, the Petitioners believe that the current $0.01 MPV is artificially wide for certain securities trading at prices below $20, including a single ETF (QQQQ) trading at greater than $20, detrimentally impacting the public price discovery process and the execution prices investors receive. The Petitioners believe implementing finer MPVs for these securities would narrow the publicly-displayed quotes, serving to ensure better prices for investors regardless of whether their orders were executed on the public markets or dark venues. By implementing a finer MPV for a limited number of securities through a pilot program of relatively short duration and at an increment that does not require an adjustment in the access fee cap of Rule 610,[6] the Petitioners believe the Commission would be afforded the opportunity to collect data and study the impact of the pilot without making a long term policy commitment to finer MPVs.

The Petitioners acknowledge past and present concerns regarding smaller quote increments causing quote flickering, jumping the queue for an economically de minimus amount, and less liquidity at the quoted spread, especially in conjunction with the SEC approval of Rule 612. The Petitioners also note that the SEC decided in its review of decimalization the benefits of smaller quote increments outweighed the costs. A limited pilot program would allow the Commission the opportunity to study the validity of these concerns without broadly impacting the market and again, without making a long term policy commitment to finer MPVs.

Finally, the Petitioners do not believe the imposition of the requested pilot program would create a substantial burden on the industry. The industry, including broker-dealers, exchanges, market data vendors, and securities information processors has adapted to sub-penny quoting and display with respect to securities priced below $1.00. The industry is also

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5 The Petitioners believe that for certain securities the optimal MPV may be less than ½ cent; however, for purposes of a pilot program the Petitioners would support a ½ cent MPV and believe that the data from the pilot will indicate whether finer MPV increments may be appropriate in some securities.

6 Currently the access fee cap in Rule 610 is $0.003 per share for securities priced at $1.00 and higher. By proposing an MPV of $0.005, the pilot program MPV is still greater than the access fee cap. This prevents a public market from displaying a protected quote that is the national best bid or offer by the MPV but is actually a worse price when the access fee is factored in.

accustomed to executing transactions in sub-penny increments regardless of the price of the security. Moreover, as noted above, participation in the pilot program would be voluntarily. Currently, Rule 612 does not require a market participant to accept, display, or rank orders in securities priced below $1.00 in sub-penny increments and some market participants do not. As proposed by the Petitioners, market participants would similarly have the option of not participating in the pilot program.

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For the foregoing reasons, the Petitioners respectfully request the Commission exercise its authority under Rule 612(c) of Regulation NMS and issue an exemptive order approving a pilot program to permit sub-penny trading at a $0.005 MPV for the securities listed on the attached appendix.

Sincerely,

Chris Isaacson, Chief Operating Officer
BATS Exchange, Inc.

Eric Noll, Executive Vice President
NASDAQ OMX Group, Inc.

Larry Leibowitz, Chief Operating Officer
NYSE Euronext, Inc.

Appendix – Securities for Inclusion in the Proposed Pilot

Name	Ticker	Listing Market	ETF
Evergreen Solar Inc.	ESLR	NNM	N
Freddie Mac	FRE	NYSE	N
Rite Aid Corp.	RAD	NYSE	N
Popular Inc.	BPOP	NNM	N
Synovus Financial Corp.	SNV	NYSE	N
RRI Energy Inc	RRI	NYSE	N
Citigroup Inc.	C	NYSE	N
American Capital Ltd.	ACAS	NNM	N
Huntington Bancshares Inc.	HBAN	NNM	N
Brocade Communications Systems Inc.	BRCD	NNM	N
Boston Scientific Corp.	BSX	NYSE	N
Tellabs Inc.	TLAB	NNM	N
Flextronics International Ltd.	FLEX	NNM	N
Marshall & Ilsley Corp.	MI	NYSE	N
ON Semiconductor Corp.	ONNN	NNM	N
AMR Corp.	AMR	NYSE	N
Advanced Micro Devices Inc.	AMD	NYSE	N
Ericsson ADR	ERIC	NNM	N
Activision Blizzard Inc.	ATVI	NNM	N
Applied Materials Inc.	AMAT	NNM	N
Yahoo! Inc.	YHOO	NNM	N
Duke Energy Corp.	DUK	NYSE	N
Pfizer Inc.	PFE	NYSE	N
Annaly Capital Management Inc.	NLY	NYSE	N
United States Natural Gas Fund, LP	UNG	ARCA	Y
iShares MSCI Japan Index Fund	EWJ	ARCA	Y
Direxion Small Cap Bear 3x Shares	TZA	ARCA	Y
Direxion Financial Bear 3x Shares	FAZ	ARCA	Y
PowerShares QQQ Trust Series 1	QQQQ	NNM	Y
Financial Select Sector SPDR	XLF	ARCA	Y

The pilot contains 12 stocks listed on NASDAQ, 12 stocks listed on NYSE, and 6 exchange traded funds.

Criteria for Selecting Securities

1. Average quoted spread was no more than 1.1 cents.
2. Average daily volume was greater than 2 million shares.
3. Minimum size quoted at the inside price across exchanges was greater than 15,000 shares.
4. Generally trades in the price range from $1 to $20 (except QQQQ).