

November 21, 2008

Executive Summary

As part of our participation in the Penny Pilot Program (“Pilot”), NYSE Alternext US, LLC, (“NYSE Alternext” or “Exchange”)(formerly the American Stock Exchange LLC), has committed to the Securities and Exchange Commission (“Commission” or “SEC”) that it would produce several reports analyzing the impact of the Pilot. Specifically the reports should assess spreads, quoted size, volumes, quote traffic and any other factors the Exchange feels are relevant. The reports are designed to better understand the impact of reducing the minimum price variations (“MPVs”) for quoting and trading options and should serve as the basis for determining how to proceed in expanding the Pilot. This will be the third report on the Pilot to date and will cover the period February 1, 2008 to July 31, 2008.

Throughout this report reference will be made to different time periods defined as follows:

- Pre-Pilot: November 1, 2006 to January 31, 2007 – data captured during this time period forms the baseline statistics for the 13 Tranche 1 securities
- Pre-Pilot: July 1, 2007 to September 27, 2008 – data captured during this time period forms the baseline statistics for the 22 Tranche 2 securities
- Phase I: February 9, 2007 to April, 30, 2007
- Phase II: May 1, 2007 to September 27, 2007
- Phase III: September 28, 2007 to January 31, 2008
- Phase IV: February 1, 2008 to July 31, 2008 – except for the 28 Tranche 3 securities which began trading on March 28, 2008. Due to data capture problems there are no Pre-Pilot observations for the 28 Tranche 3 securities. Also, during the pilot reporting period, 2 of the 28 Tranche 3 securities stopped trading. Data for both BSC and CFC is only through the dates they were traded prior to delisting by the NYSE.

The Pilot has now been in effect for well over a year. In that time observed spreads have declined, size at the NBBO has been reduced, and quote traffic has increased substantially. Observations about volume are harder to quantify given the market conditions, particularly as of late, that has led to substantially increased volatility in the market place.

One of the developments to occur since the time of the last Pilot report has been the approval and launch of the Nasdaq Options Market and the price improvement mechanism

employed by Nasdaq. The process that price improvement is offered involves taking in penny priced quotes and orders and rounding them to the nearest MPV for display through OPRA while retaining the penny priced quotes and orders in the system to match with incoming quotes and orders. This process (“dark pennies”) can arguably have the effect of reducing transparency in the options markets. It is the Exchange’s belief that greater transparency, not less, is more beneficial to investors and the options markets as a whole. As such, NYSE Alternext recommends expanding the Pilot to include the top 350 names by industry volume so that all investors may benefit from the greater transparency offered by explicit penny quoting vs. dark pennies. By expanding the Pilot to the top 350 names by industry volume, fully 90% of the daily volume transacted would be included in the Pilot. The expansion should retain the \$3 breakpoint for penny quoting below and nickel quoting above since the industry has utilized this breakpoint for many years and investors are accustomed to it. The \$3 breakpoint would also offer the greatest benefit to investors in terms of the potential to reduce spreads when viewed against the premium paid or received. The Exchange also recommends adding 100 new securities to the Pilot each quarter beginning April 1, 2009 and every quarter thereafter until the top 350 names are in the Pilot. Each quarter subsequent to that, the most active names could be added as needed to reach the 350 level as stocks leave the Pilot by merger, bankruptcy or other corporate action.

Methodology Overview

NYSE Alternext was concerned with getting the most accurate and meaningful data possible out of the Pilot. To that end, we developed a fairly robust methodology for capturing and subsequently analyzing various metrics. OPRA data was used in compiling all of the quote-related statistics. Volume related statistics were derived from OCC volume files.

Summary Statistics Described

Each series associated with an underlying security in the Pilot was categorized based on the NBBO bid price throughout the trading day. The data was then analyzed each day with the following summary statistics produced at days end.

NBBO Quotes						Open Interest Total For Series Priced \$.00				
Count Of Series Priced \$.00						Open Interest Total For Series Priced Above \$.00				
Count Of Series Priced Above \$.00						Open Interest Total For Series Priced \$.01 to \$1.00				
Count Of Series Priced \$.01 to \$1.00						Open Interest Total For Series Priced \$1.00 to \$2.00				
Count Of Series Priced \$1.00 to \$2.00						Open Interest Total For Series Priced \$2.00 to \$3.00				
Count Of Series Priced \$2.00 to \$3.00						Open Interest Total For Series Priced \$3.00 to \$5.00				
Count Of Series Priced \$3.00 to \$5.00						Open Interest Total For Series Priced Above \$5.00				
Count Of Series Priced Above \$5.00						Open Interest Total For All Series				
Count Of Option Series										
Average Bid Size For All Series Priced \$.00						Average Ask Size For All Series Priced \$.00				
Average Bid Size For All Series Priced Above \$.00						Average Ask Size For All Series Priced Above \$.00				

Average Bid Size For Series Priced \$.01 to \$1.00			Average Ask Size For Series Priced \$.01 to \$1.00		
Average Bid Size For Series Priced \$1.00 to \$2.00			Average Ask Size For Series Priced \$1.00 to \$2.00		
Average Bid Size For Series Priced \$2.00 to \$3.00			Average Ask Size For Series Priced \$2.00 to \$3.00		
Average Bid Size For Series Priced \$3.00 to \$5.00			Average Ask Size For Series Priced \$3.00 to \$5.00		
Average Bid Size For Series Priced Above \$5.00			Average Ask Size For Series Priced Above \$5.00		
Average Bid Size For All Series			Average Ask Size For All Series		
Open Interest Weighted Bid Size For All Series Priced \$.00			Open Interest Weighted Ask Size For All Series Priced \$.00		
Open Interest Weighted Bid Size For All Series Priced Above \$.00			Open Interest Weighted Ask Size For All Series Priced Above \$.00		
Open Interest Weighted Bid Size For Series Priced \$.01 to \$1.00			Open Interest Weighted Ask Size For Series Priced \$.01 to \$1.00		
Open Interest Weighted Bid Size For Series Priced \$1.00 to \$2.00			Open Interest Weighted Ask Size For Series Priced \$1.00 to \$2.00		
Open Interest Weighted Bid Size For Series Priced \$2.00 to \$3.00			Open Interest Weighted Ask Size For Series Priced \$2.00 to \$3.00		
Open Interest Weighted Bid Size For Series Priced \$3.00 to \$5.00			Open Interest Weighted Ask Size For Series Priced \$3.00 to \$5.00		
Open Interest Weighted Bid Size For Series Priced Above \$5.00			Open Interest Weighted Ask Size For Series Priced Above \$5.00		
Open Interest Weighted Bid Size For All Series			Open Interest Weighted Ask Size For All Series		
Average Spread For All Series Priced \$.00			Open Interest Weighted Spread For All Series Priced \$.00		
Average Spread For All Series Priced Above \$.00			Open Interest Weighted Spread For All Series Priced Above \$.00		
Average Spread For Series Priced \$.01 to \$1.00			Open Interest Weighted Spread For Series Priced \$.01 to \$1.00		
Average Spread For Series Priced \$1.00 to \$2.00			Open Interest Weighted Spread For Series Priced \$1.00 to \$2.00		
Average Spread For Series Priced \$2.00 to \$3.00			Open Interest Weighted Spread For Series Priced \$2.00 to \$3.00		
Average Spread For Series Priced \$3.00 to \$5.00			Open Interest Weighted Spread For Series Priced \$3.00 to \$5.00		
Average Spread For Series Priced Above \$5.00			Open Interest Weighted Spread For Series Priced Above \$5.00		
Average Spread For All Series			Open Interest Weighted Spread For All Series		
Daily Quotes Per Series					
Number Of Quotes Per Day All Series					

It is important to note that while utilizing a simple average across all series associated with an underlying security yields important information, it does not take into account the fact that some series are more actively traded than others. For that reason we decided to utilize open interest as a measure of investor activity and to weight important metrics such as size at the NBBO and the quoted spread width by open interest as well as calculating a simple average. One of the ancillary benefits of weighting by open interest rather than volume is that open interest is generally somewhat insulated from the effects of “strategy trades” whereas volume is not. For example, it is common to see hundreds of thousands and sometimes millions of contracts trade as part of a “strategy trade” against open interest of 50,000 contracts. The seemingly outsized volume as compared to the available open interest is a result of the random nature of exercises and assignments and an attempt by people entering into these “strategy trades” to capture as much of the open interest as possible. This is done by trading what is typically a spread involving deep in-the-money options and immediately exercising the long side of the spread so that the volume of 1,000,000 contracts will almost never show up in the open interest figures the next day despite seeing only 50,000 contracts of open interest the day the “strategy trade” took place. Additionally, any analysis which considers trades as part of the analysis is subject to distortion as a result of these strategy trades. The Exchange would argue that the riskless

nature of “strategy trades” and the very low capped costs (as little as \$100 per day regardless of volume executed) has increased the prevalence of these types of trades rendering any trade weighted measure such as effective spread of little or no use. The Exchange continues to believe that it is important to better understand how trades of this nature are influencing the results of the Pilot and would ask the SEC to request from each exchange details of any such “strategy trades” so that their impact can be discounted accordingly.

Once the daily summary statistics were compiled they were then aggregated for the pertinent time periods for each underlying security and averaged accordingly. Each day in the evaluation period was given equal weight in the averaging process.

Observations About The NBBO Quoted Spread Width

Classifying option series on the basis of where the bid price was observed to be allows for a better understanding of which series benefit the most from the reduction in the MPV’s. The Tranche 1 Pilot securities when weighted by open interest, reveals that the quoted spread for all series regardless of price, declined from \$.09 to \$.06 in Phase IV as compared to the Pre-Pilot period. This is slightly wider than what was observed in Phase II where the reduction in spread width was \$.01 greater and Phase I where the reduction was a full \$.02 greater. The widening of spreads is most likely due to less quote competition combined with greater volatility in the market place.

	All Tranche 1 Securities	Pre-Pilot Spread	Phase I Spread	Phase II Spread	Phase III Spread	Phase IV Spread
Tranche 1	Open Interest Weighted Spread For All Series Priced \$\$.00	\$0.06	\$0.02	\$0.02	\$0.02	\$0.02
Tranche 1	Open Interest Weighted Spread For All Series Priced Above \$.00	\$0.09	\$0.04	\$0.05	\$0.06	\$0.06
Tranche 1	Open Interest Weighted Spread For Series Priced \$.01 to \$1.00	\$0.07	\$0.02	\$0.02	\$0.02	\$0.02
Tranche 1	Open Interest Weighted Spread For Series Priced \$1.00 to \$2.00	\$0.08	\$0.03	\$0.04	\$0.04	\$0.04
Tranche 1	Open Interest Weighted Spread For Series Priced \$2.00 to \$3.00	\$0.09	\$0.05	\$0.05	\$0.05	\$0.05
Tranche 1	Open Interest Weighted Spread For Series Priced \$3.00 to \$5.00	\$0.15	\$0.09	\$0.10	\$0.10	\$0.10
Tranche 1	Open Interest Weighted Spread For Series Priced Above \$5.00	\$0.17	\$0.11	\$0.14	\$0.15	\$0.17
Tranche 1	Open Interest Weighted Spread For All Series	\$0.09	\$0.04	\$0.05	\$0.06	\$0.06

The Tranche 2 Pilot securities when weighted by open interest, reveals that the quoted spread for all series regardless of price, declined from \$.15 to \$.09 in Phase IV as compared to the Pre-Pilot period. The inclusion of high dollar securities in Tranche 2 such as OIH and AAPL, coupled with higher volatility are likely the reason for the difference in spread reduction versus the Tranche 1 securities.

	Tranche 2 Securities	Pre-Pilot Spread	Phase III Spread	Phase IV Spread
Tranche 2	Open Interest Weighted NBBO Spread For All Series Priced \$.00	\$0.06	\$0.03	\$0.03
Tranche 2	Open Interest Weighted NBBO Spread For All Series Priced Above \$.00	\$0.15	\$0.11	\$0.09
Tranche 2	Open Interest Weighted NBBO Spread For Series Priced \$.01 to \$1.00	\$0.08	\$0.03	\$0.03
Tranche 2	Open Interest Weighted NBBO Spread For Series Priced \$1.00 to \$2.00	\$0.10	\$0.05	\$0.05
Tranche 2	Open Interest Weighted NBBO Spread For Series Priced \$2.00 to \$3.00	\$0.12	\$0.07	\$0.06
Tranche 2	Open Interest Weighted NBBO Spread For Series Priced \$3.00 to \$5.00	\$0.19	\$0.13	\$0.12
Tranche 2	Open Interest Weighted NBBO Spread For Series Priced Above \$5.00	\$0.29	\$0.23	\$0.20
Tranche 2	Open Interest Weighted NBBO Spread For All Series	\$0.15	\$0.10	\$0.09

As noted earlier, due to a problem with data capture, the Exchange does not have baseline statistics for the "Pre-Pilot" period covering January 2008 to March 2008 for the 28 Tranche 3 securities. Despite this there is still value in observing what spreads were for that group of securities. In Phase IV the Exchange observed that for all 28 securities, across all associated series, when weighted by open interest, the NBBO spread was \$.10. The higher spread associated with the Tranche 3 securities is likely a result of the number of financial services related securities in Tranche 3 which have seen exceptionally high levels of volatility.

	All Tranche 3 Securities	Phase IV Spread
Tranche 3	Open Interest Weighted NBBO Spread For All Series Priced \$.00	\$0.06
Tranche 3	Open Interest Weighted NBBO Spread For All Series Priced Above \$.00	\$0.11

Tranche 3	Open Interest Weighted NBBO Spread For Series Priced \$.01 to \$1.00	\$0.04
Tranche 3	Open Interest Weighted NBBO Spread For Series Priced \$1.00 to \$2.00	\$0.06
Tranche 3	Open Interest Weighted NBBO Spread For Series Priced \$2.00 to \$3.00	\$0.07
Tranche 3	Open Interest Weighted NBBO Spread For Series Priced \$3.00 to \$5.00	\$0.13
Tranche 3	Open Interest Weighted NBBO Spread For Series Priced Above \$5.00	\$0.26
Tranche 3	Open Interest Weighted NBBO Spread For All Series	\$0.10

As seen in earlier phases of the Pilot, the majority of the economic benefit accrues to buyers and seller of lower priced options when the spread is viewed as a percentage of the premium paid. These observations form the basis for the Exchanges recommendation to retain the nickel MPV for quoting above \$3 when the Pilot is expanded. Exhibits A-1,A-2, and A-3 contain detailed information on each of the Pilot securities with respect to the quoted spread width.

Observations About Total Size At The NBBO

The total size at the NBBO (bid size plus ask size) was observed to be 88% less during Phase IV as compared to the Pre-Pilot period for the Tranche 1 securities.

	All Tranche 1 Securities	Pre-Pilot Size	Phase I Size	Phase II Size	Phase III Size	Phase IV Size
Tranche 1	Open Interest Weighted NBBO Size For All Series Priced \$.00	24,267	7,328	4,808	2,168	2,745
Tranche 1	Open Interest Weighted NBBO Size For All Series Priced Above \$.00	59,976	10,408	8,661	5,441	6,739
Tranche 1	Open Interest Weighted NBBO Size For Series Priced \$.01 to \$1.00	83,704	12,382	11,585	6,059	7,134
Tranche 1	Open Interest Weighted NBBO Size For Series Priced \$1.00 to \$2.00	59,197	9,982	6,513	4,610	5,672
Tranche 1	Open Interest Weighted NBBO Size For Series Priced \$2.00 to \$3.00	33,728	6,334	4,791	3,949	5,951

Tranche 1	Open Interest Weighted NBBO Size For Series Priced \$3.00 to \$5.00	29,622	9,083	7,990	6,639	9,386
Tranche 1	Open Interest Weighted NBBO Size For Series Priced Above \$5.00	20,569	5,871	5,180	4,745	5,335
Tranche 1	Open Interest Weighted NBBO Size For All Series	53,805	10,280	8,548	5,234	6,513

For the Tranche 2 Pilot securities the decline in size quoted at the NBBO for all series was 63%.

	All Tranche 2 Securities	Pre-Pilot Size	Phase III Size	Phase IV Size
Tranche 2	Open Interest Weighted NBBO Size For All Series Priced \$.00	8,301	2,258	3,584
Tranche 2	Open Interest Weighted NBBO Size For All Series Priced Above \$.00	13,792	3,945	5,100
Tranche 2	Open Interest Weighted NBBO Size For Series Priced \$.01 to \$1.00	15,871	2,826	4,021
Tranche 2	Open Interest Weighted NBBO Size For Series Priced \$1.00 to \$2.00	15,107	2,526	2,796
Tranche 2	Open Interest Weighted NBBO Size For Series Priced \$2.00 to \$3.00	12,443	2,383	2,818
Tranche 2	Open Interest Weighted NBBO Size For Series Priced \$3.00 to \$5.00	16,581	7,502	9,757
Tranche 2	Open Interest Weighted NBBO Size For Series Priced Above \$5.00	8,000	5,040	6,672
Tranche 2	Open Interest Weighted NBBO Size For All Series	13,393	3,838	5,006

For the Tranche 3 securities the total size at the NBBO, was observed to be 2,116 contracts.

	All Tranche 3 Securities	Phase IV Size
Tranche 3	Open Interest Weighted NBBO Size For All Series Priced \$.00	1,151

Tranche 3	Open Interest Weighted NBBO Size For All Series Priced Above \$.00	2,182
Tranche 3	Open Interest Weighted NBBO Size For Series Priced \$.01 to \$1.00	2,031
Tranche 3	Open Interest Weighted NBBO Size For Series Priced \$1.00 to \$2.00	1,532
Tranche 3	Open Interest Weighted NBBO Size For Series Priced \$2.00 to \$3.00	1,519
Tranche 3	Open Interest Weighted NBBO Size For Series Priced \$3.00 to \$5.00	4,008
Tranche 3	Open Interest Weighted NBBO Size For Series Priced Above \$5.00	2,231
Tranche 3	Open Interest Weighted NBBO Size For All Series	2,116

The observations for individual names are detailed in Exhibit B-1, B-2 and B-3 for the Tranche 1, 2, and 3 securities respectively.

Observations About Volume

As noted earlier, exceptional volatility has made making any observation on volume difficult at best. Volume in the ETF's that are part of the Pilot continues to grow at the fastest pace of any of the Pilot securities. In the table below, the growth in the ETF volumes can clearly be seen relative to the other Pilot securities and the overall industry as a whole.

Under	Phase I vs Pre Pilot % Change	Phase II Vs Pre Pilot % Change	Phase III vs Pre Pilot % Change	Phase IV vs Pre Pilot % Change
Industry ADV	10%	26%	56%	53%
SubTotal 13 Pilot Securities	31%	60%	92%	60%
SubTotal 22 Pilot Securities	14%	41%	96%	97%
SubTotal 28 Pilot Securities	-11%	13%	52%	52%
SubTotal All Pilot Securities	12%	40%	83%	74%
SubTotal ETF Pilot Securities	45%	109%	184%	188%
SubTotal Pilot Securities Ex ETFs	-2%	9%	39%	24%
Industry ADV Ex Pilot Securities	8%	17%	35%	37%

Please see Exhibits C-1, C-2, C-3, and C-4 for observations on the trends in volume for individual Pilot securities in the various participant categories – Customer, Firm, and Market Maker, as well as overall Industry Volume.

Observations On Quote Traffic

Quote traffic continues to grow as more securities have been added to the Pilot, coupled with exceptionally high volatility. Tranche 1 securities saw an increase of 154% in quote traffic versus the Pre-Pilot when measured in terms of average daily quotes per series. 11 of the 13 Tranche 1 securities experienced increases of more than 100% in Phase IV. Tranche 2 securities experienced a growth in quote traffic of 79% in Phase III as compared to the Pre-Pilot period. The Exchange unfortunately does not have comparative statistics for the Tranche 3 securities. Please see Exhibits D-1, D-2, and D-3 for detailed observations on quote traffic.

Observations On Trade Throughs

During the Pilot, the Exchange did not see any meaningful change in the amount or magnitude of trade throughs for orders executed on our Exchange.