

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-66346; File Nos. SR-NYSE-2011-55; SR-NYSEAmex-2011-84]

### Self-Regulatory Organizations; New York Stock Exchange LLC; NYSE Amex LLC; Order Instituting Proceedings To Determine Whether To Disapprove Proposed Rule Changes, as Modified by Amendments No. 1, Adopting NYSE Rule 107C To Establish a Retail Liquidity Program for NYSE-Listed Securities on a Pilot Basis Until 12 Months From Implementation Date, Which Shall Occur No Later Than 90 Days After Approval, If Granted and Adopting NYSE Amex Rule 107C To Establish a Retail Liquidity Program for NYSE Amex Equities Traded Securities on a Pilot Basis Until 12 Months From Implementation Date, Which Shall Occur No Later Than 90 Days After Approval, If Granted

February 7, 2012.

#### I. Introduction

On October 19, 2011, New York Stock Exchange LLC (“NYSE”) and NYSE Amex LLC (“NYSE Amex”) and together with NYSE, the “Exchanges”) each filed with the Securities and Exchange Commission (“Commission”) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to establish a Retail Liquidity Program (“Program”) on a pilot basis for a period of one year from the date of implementation, if approved. The proposed rule changes were published for comment in the **Federal Register** on November 9, 2011.<sup>3</sup> The Commission received 28 comments on the NYSE proposal<sup>4</sup> and 4 comments on the NYSE

Amex proposal.<sup>5</sup> On December 19, 2011, the Commission designated a longer period for Commission action on the proposed rule change, until February 7, 2012.<sup>6</sup> In connection with the proposals, the Exchanges requested exemptive relief from Rule 612(c) of Regulation NMS,<sup>7</sup> which prohibits a national securities exchange from accepting or ranking certain orders based on an increment smaller than the minimum pricing increment.<sup>8</sup> The Exchanges submitted a consolidated response letter on January 3, 2012.<sup>9</sup> On January 17, 2012, each Exchange filed Amendment No. 1 to its proposal.<sup>10</sup>

Schafer, President, Great Mountain Capital Management LLC, dated November 29, 2011 (“Great Mountain Capital Letter”); Wayne Koch, Trader, Bright Trading, dated November 29, 2011 (“Koch Letter”); Kurt Schact, CFA, Managing Director, and James Allen, CFA, Head, Capital Markets Policy, CFA Institute, dated November 30, 2011 (“CFA Letter”); David Green, Bright Trading, dated November 30, 2011 (“Green Letter”); Robert Bright, Chief Executive Officer, and Dennis Dick, CFA, Market Structure Consultant, Bright Trading LLC, dated November 30, 2011 (“Bright Trading Letter”); Bodil Jelsness, dated November 30, 2011 (“Jelsness Letter”); Christopher Nagy, Managing Director, Order Routing and Market Data Strategy, TD Ameritrade, dated November 30, 2011 (“TD Ameritrade Letter”); Laura Kenney, dated November 30, 2011 (“Kenney Letter”); Suhas Daftuar, Hudson River Trading LLC, dated November 30, 2011 (“Hudson River Trading Letter”); Bosier Parsons, Bright Trading LLC, dated November 30, 2011 (“Parsons Letter”); Mike Stewart, Head of Global Equities, UBS, dated November 30, 2011 (“UBS Letter”); Dr. Larry Paden, Bright Trading, dated December 1, 2011 (“Paden Letter”); Thomas Dercks, dated December 1, 2011 (“Dercks Letter”); Eric Swanson, Secretary, BATS Global Markets, Inc., dated December 6, 2011 (“BATS Letter”); Ann Vlcek, Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated December 7, 2011 (“SIFMA Letter”); and Al Patten, dated December 29, 2011 (“Patten Letter”).

<sup>5</sup> See Knight Letter; CFA Letter; TD Ameritrade Letter; and letter to the Commission from Shannon Jennewein, dated November 30, 2011 (“Jennewein Letter”).

<sup>6</sup> See Securities Exchange Act Release No. 66003, 76 FR 80445 (December 23, 2011).

<sup>7</sup> 17 CFR 242.612(c).

<sup>8</sup> The Exchanges amended the exemptive relief request on January 13, 2012. See Letter from Janet M. McGinness, Senior Vice President—Legal and Corporate Secretary, Office of the General Counsel, NYSE Euronext to Elizabeth M. Murphy, Secretary, Commission.

<sup>9</sup> See Letter to the Commission from Janet McGinness, Senior Vice President, Legal & Corporate Secretary, Legal & Government Affairs, NYSE Euronext, dated January 3, 2012 (“Exchanges’ Response Letter”).

<sup>10</sup> In Amendment No. 1, the Exchanges modified the proposals as follows: (1) To state that Retail Member Organizations may receive free executions for their retail orders and the fees and credits for liquidity providers and Retail Member Organizations would be determined based on experience with the Retail Liquidity Program in the first several months; (2) to correct a typographical error referring to the amount of minimum price improvement on a 500 share order; (3) to indicate the Retail Liquidity Identifier would be initially available on each Exchange’s proprietary data feeds, and would be later available on the public market

This order institutes proceedings under Section 19(b)(2)(B) of the Act to determine whether to disapprove the proposed rule changes.

#### II. Description of the Proposals

Each Exchange is proposing to establish a Retail Liquidity Program on a pilot basis, limited to trades occurring at prices equal to or greater than \$1.00 per share. According to the Exchanges, the Retail Liquidity Program is intended to attract retail order flow to the NYSE for NYSE-listed securities, and to NYSE Amex for NYSE Amex-listed securities as well as securities listed on the Nasdaq Stock Market and traded pursuant to unlisted trading privileges. The proposed Retail Liquidity Program would allow such order flow to receive potential price improvement.

Under the proposed Program, a new class of market participants called Retail Member Organizations could submit a new type of order, called a Retail Order, to the Exchange. Once a Retail Member Organization submitted a Retail Order, a new class of market participants called Retail Liquidity Providers would then be required to provide potential price improvement, in the form of non-displayed interest that is better than the best protected bid or offer (“PBBO”),<sup>11</sup> called a Retail Price Improvement Order. Other Exchange member organizations would be allowed, but not required, to submit Retail Price Improvement Orders. The Exchanges would approve member organizations to be Retail Liquidity Providers and/or Retail Member Organizations.

#### Types of Orders and Identifier

As set forth in the proposals, a Retail Order would be an immediate or cancel order, and could have two different sources of origination. A Retail Order could be an agency order that originated from a natural person and not a trading algorithm or any other computerized methodology. The Retail Member Organization may not alter the terms of such order with respect to price or side

data stream; and (4) to limit the Retail Liquidity Program to securities that trade at prices equal to or greater than \$1 per share.

<sup>11</sup> The terms protected bid and protected offer would have the same meaning as defined in Rule 600(b)(57) of Regulation NMS. Rule 600(b)(57) of Regulation NMS defines “protected bid” and “protected offer” as “a quotation in an NMS stock that: (i) [i]s displayed by an automated trading center; (ii) [i]s disseminated pursuant to an effective national market system plan; and (iii) [i]s an automated quotation that is the best bid or best offer of a national securities exchange, the best bid or best offer of the Nasdaq Stock Market, Inc., or the best bid or best offer of a national securities association other than the best bid or best offer of the Nasdaq Stock Market, Inc.” 17 CFR 242.600(b)(57).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release Nos. 65671 (November 2, 2011), 76 FR 69774 (SR-NYSE Amex-2011-84); 65672 (November 2, 2011), 76 FR 69788 (SR-NYSE-2011-55).

<sup>4</sup> See Letters to the Commission from Sal Arnuk, Joe Saluzzi and Paul Zajac, Themis Trading LLC, dated October 17, 2011 (“Themis Letter”); Garret Cook, dated November 4, 2011 (“Cook Letter”); James Johannes, dated November 27, 2011 (“Johannes Letter”); Ken Voorhies, dated November 28, 2011 (“Voorhies Letter”); William Wuepper, dated November 28, 2011 (“Wuepper Letter”); A. Joseph, dated November 28, 2011 (“Joseph Letter”); Leonard Amoroso, General Counsel, Knight Capital, Inc., dated November 28, 2011 (“Knight Letter”); Kevin Basic, dated November 28, 2011 (“Basic Letter”); J. Fournier, dated November 28, 2011 (“Fournier Letter”); Ullrich Fischer, CTO, PairCo, dated November 28, 2011 (“PairCo Letter”); James Angel, Associate Professor of Finance, McDonough School of Business, Georgetown University, dated November 28, 2011 (“Angel Letter”); Jordan Wollin, dated November 29, 2011 (“Wollin Letter”); Aaron

of the market. Alternately, Retail Order could be proprietary order of a Retail Member Organization that resulted from liquidating a position acquired from the internalization of a Retail Order.

The Retail Liquidity Provider would be required to submit Retail Price Improvement Orders for securities that are assigned to the Retail Liquidity Provider. The Retail Price Improvement Order would be priced better than the PBBO by at least \$0.001. The Exchange systems would determine whether a Retail Price Improvement Order could interact with incoming Retail Orders.

When a Retail Price Improvement Order is available, the Exchange would disseminate an identifier, called a Retail Liquidity Identifier. The identifier would initially be disseminated through an Exchange proprietary data feed, and as soon as practicable, the Exchange would disseminate the identifier through the Consolidated Quotation System.

#### *Retail Member Organizations*

In order to become a Retail Member Organization, an Exchange member organization must conduct a retail business or handle retail orders on behalf of another broker-dealer. The member organization must submit an application with supporting documentation and an attestation to the Exchange that the order flow would qualify as Retail Orders.

The Exchange would review the application and notify the member organization of the Exchange's decision in writing. If a member organization did not receive approval to become a Retail Member Organization, then the member organization could appeal as provided below or reapply 90 days after the Exchange issued the disapproval.

The Exchange would require a Retail Member Organization to have written policies and procedures in place to assure that only bona fide retail orders are designated as such. The written policies and procedures would require that the Retail Member Organization exercise due diligence to assure that entry of a Retail Order is in compliance with the proposed rule, prior to such entry. In addition, the Retail Member Organization must monitor whether the Retail Order meets the requirements of the proposed rule.

If the Retail Member Organization represented the Retail Order from another broker-dealer, then the Retail Member Organization must have adequate supervisory procedures to assure that the Retail Order meets the proposed definition. Every year, the Retail Member Organization must obtain from each broker-dealer a written

representation that the Retail Orders the broker-dealer sends comply with the proposed rule and must monitor the broker-dealer's order flow to meet the requirements of the proposed rule.

#### *Retail Order Interactions*

Under the proposal, a Retail Member submitting a Retail Order could choose one of three ways for the Retail Order to interact with available contra-side interest. First, a Retail Order could interact only with available contra-side Retail Price Improvement Orders. The Exchange would label this a Type 1 Retail Order and such orders would not interact with other available contra-side interest in Exchange systems or route to other markets. Portions not executed would be cancelled.

Second, a Retail Order could interact first with available contra-side Retail Price Improvement Orders and any remaining portion would be executed as a Regulation NMS-compliant Immediate or Cancel Order (such order would sweep the Exchange's book without being routed to other markets, and any remaining portion would be cancelled). The Exchange would label this a Type 2 Retail Order.

Finally, a Retail Order could interact first with available contra-side Retail Price Improvement Orders and any remaining portion would be executed as a NYSE Immediate or Cancel Order (such order would sweep the Exchange's book and be routed to other markets to comply with Regulation NMS and any remaining portion would be cancelled). The Exchange would label this a Type 3 Retail Order.

#### *Priority and Allocation*

The proposals set forth how Retail Price Improvement Orders are ranked in the same security. The Exchange would follow a price and time allocation, ranking Retail Price Improvement Orders according to price and then time of entry. Executions would occur at the price that completes the incoming order. If there are remaining Retail Price Improvement Orders, they would be available for further incoming Retail Orders. As noted earlier, Retail Orders not executed would be cancelled.

#### *Retail Liquidity Providers Qualifications and Admission*

The proposed rule would set forth the qualifications, application process, requirements, and penalties of Retail Liquidity Providers.

To qualify, a member organization must be approved as a Designated Market Maker<sup>12</sup> or Supplemental

Liquidity Provider<sup>13</sup> on the Exchange and demonstrate an ability to meet the requirements of a Retail Liquidity Provider. Moreover, the member organization must have mnemonics or the ability to accommodate other Exchange-supplied designations that identify to the Exchange Retail Liquidity Provider trading activity in assigned securities.<sup>14</sup> Finally, to qualify, the member organization must have adequate trading infrastructure and technology to support electronic trading.

A member organization must submit an application with supporting documentation to the Exchange. Thereafter, the Exchange would notify whether the member organization is approved as a Retail Liquidity Provider. More than one member organization could act as a Retail Liquidity Provider for a security, and a member organization could act as a Retail Liquidity Provider for more than one security. A member organization could request the Exchange to be assigned certain securities. Once approved, the member organization must establish connectivity with relevant Exchange systems prior to trading.

The Exchange would notify a member organization in writing if the Exchange does not approve the member organization's application to be a Retail Liquidity Provider. Such member organization could request an appeal as provided below. The member organization could also reapply 90 days after the Exchange issues the disapproval notice.

Once approved as a Retail Liquidity Provider, a member organization could withdraw by providing notice to the Exchange. The withdrawal would become effective when the Exchange reassigns the securities to another Retail Liquidity Provider, no later than 30 days after the Exchange receives the withdrawal notice. In the event that the Exchange takes longer than 30 days to reassign the securities, the withdrawing Retail Liquidity Provider would have no further obligations under the proposed rule.

#### *Retail Liquidity Provider Requirements*

The proposed rule would impose several requirements on Retail Liquidity Providers. First, a Retail Liquidity

<sup>13</sup> See NYSE Rule 107B and NYSE Amex Rule 107B.

<sup>14</sup> The member organization would not be allowed to use the mnemonic or designation for non-Retail Liquidity Provider trading activities. Further, the member organization would not receive credit for Retail Liquidity Provider trading activity if the member organization did not use mnemonic or designation.

<sup>12</sup> See NYSE Rule 103 and NYSE Amex Rule 103.

Provider could only enter a Retail Price Improvement Order electronically into Exchange systems specifically designated for this purpose, and only for the securities to which the Retail Liquidity Provider is assigned. The Retail Liquidity Provider must maintain Retail Price Improvement Orders that are better than the PBBO at least 5% of the trading day for each assigned security.

To calculate the 5% quoting requirement, the Exchange would determine the average percentage of time a Retail Liquidity Provider maintains a Retail Price Improvement Order in each assigned security during the regular trading day on a daily and monthly basis. The Exchange would use the following definitions. The "Daily Bid Percentage" would be calculated by determining the percentage of time a Retail Liquidity Provider maintains a Retail Price Improvement Order with respect to the best protected bid during each trading day for a calendar month. The "Daily Offer Percentage" would be calculated by determining the percentage of time a Retail Liquidity Provider maintains a Retail Price Improvement Order with respect to the best protected offer during each trading day for a calendar month. The "Monthly Average Bid Percentage" would be calculated for each security by summing the security's "Daily Bid Percentages" for each trading day in a calendar month, then dividing the resulting sum by the total number of trading days in such month. The "Monthly Average Offer Percentage" would be calculated for each security by summing the security's "Daily Offer Percentages" for each trading day in a calendar month, then dividing the resulting sum by the total number of trading days in such month.

The proposed rule specifies that only Retail Price Improvement Orders entered through the trading day would be used when calculating the 5% quoting requirements. Further, a Retail Liquidity Provider would have a two-month grace period from the 5% quoting requirement. The Exchange would impose the 5% quoting requirements on the first day of the third consecutive calendar month after the member organization began operation as a Retail Liquidity Provider.

#### *Penalties for Failure To Meet Requirements*

The proposed rules provide for penalties when a Retail Liquidity Provider or a Retail Member Organization fails to meet the requirements of the rule.

If a Retail Liquidity Provider fails to meet the 5% quoting requirements in any assigned securities for three consecutive months, the Exchange, in its sole discretion, may: (1) Revoke the assignment of all affected securities; (2) revoke the assignment of unaffected securities; or (3) disqualify the member organization to serve as a Retail Liquidity Provider. If the Exchange moves to disqualify a Retail Liquidity Provider's status, then the Exchange would notify, in writing, the Retail Liquidity Provider one calendar month prior to the determination. Likewise, the Exchange would notify the Retail Liquidity Provider in writing if the Exchange determined to disqualify the status of that Retail Liquidity Provider. As noted earlier, a Retail Liquidity Provider that is disqualified may appeal as provided below or reapply.

With respect to Retail Member Organizations, the Exchange could disqualify a Retail Member Organization if the Retail Order submitted by the Retail Member Organization did not comply with the requirements of the proposed rule. The Exchange would have sole discretion to make such determination. The Exchange would provide written notice to the Retail Member Organization when disqualification determinations are made. Similar to a disqualified Retail Liquidity Provider, a disqualified Retail Member Organization could appeal as provided below or reapply.

#### *Appeal Process*

Under the proposals, the Exchange would establish a Retail Liquidity Program Panel to review disapproval or disqualification decisions. An affected member organization would have five business days after notice to request an adverse review. If a member organization is disqualified as a Retail Liquidity Provider and has appealed, the Exchange would stay the reassignment of securities.

The Panel would consist of the Exchange's Chief Regulatory Officer or its designee, and two officers of the Exchange as designated by the co-head of U.S. Listings and Cash Execution. The Panel would review the appeal and issue a decision within the time frame prescribed by the Exchange. The Panel's decision would constitute final action by the Exchange, and the Panel could modify or overturn any Exchange action taken under the proposed rule.

### **III. Comments Letters and the Exchanges' Response**

As noted above, the Commission received 28 comment letters concerning the NYSE proposal and 4 comment

letters concerning the NYSE Amex proposal. Several commenters expressed support for some or all elements of the Exchanges' proposed Program.<sup>15</sup> For instance, one commenter expressed general support for the proposals<sup>16</sup> and another commenter offered support for the Exchanges' efforts to enhance price competition for retail customer order flow.<sup>17</sup> Another commenter was supportive of the proposals to the extent they promoted transparency, competition, efficiency, and greater investor choice in the capital markets.<sup>18</sup> Two other commenters expressed broad support for the proposals' potential to benefit individual retail investors.<sup>19</sup>

However, a number of commenters raised concerns about the proposed rule changes. The main areas of concern were: (1) The time and manner of the Commission's action on the proposed rule changes, given the potential impact on overall market structure; (2) the proposals' impact on the Sub-Penny Rule; (3) whether the proposals impede fair access; and (4) whether the proposals implicate rules and standards relating to best execution and order protection.

#### **1. Time and Manner of Commission Action**

Several commenters requested that the Commission delay taking action on the proposals until the Commission has had additional time to examine the proposals' potential impact on market structure.<sup>20</sup> For example, several commenters stated their belief that the issues raised by the proposals should be considered through Commission rulemaking, rather than through a self-regulatory organization's proposed rule change, because of the proposals' impact on the Sub-Penny Rule (Rule 612) of Regulation NMS<sup>21</sup> as well as the competitive landscape of the markets.<sup>22</sup> Commenters questioned whether the standard action period applicable to self-regulatory organizations' proposed rule changes was enough time for the Commission to analyze relevant data

<sup>15</sup> See Johannes Letter, Knight Letter, Angel Letter, TD Ameritrade Letter, UBS Letter, Dercks Letter, and BATS Letter.

<sup>16</sup> See TD Ameritrade Letter (stating that the proposals are "quite appealing" to the interests of "fair and transparent markets that benefit retail investors" although there were still specific issues to be addressed).

<sup>17</sup> See BATS Letter.

<sup>18</sup> See UBS Letter.

<sup>19</sup> See Johannes Letter and Dercks Letter.

<sup>20</sup> In contrast, one commenter requested the Commission to expedite approval of the proposals. See Johannes Letter.

<sup>21</sup> See Knight Letter and SIFMA Letter.

<sup>22</sup> See Knight Letter and Hudson River Trading Letter.

and sufficiently consider the effects the proposals might have on the equities markets.<sup>23</sup> Another commenter did not oppose Commission approval of the proposals on a pilot basis, but cautioned that to the extent the Commission approves an effective reduction in the minimum price variation, or “tick size,” below \$0.01, the Commission should do so on the basis of industry-wide pilot studies that test various tick sizes and publish the studies’ data for public review and comment.<sup>24</sup>

The Exchanges responded that the proposed Program is designed to attract retail order flow to the Exchanges by competing with the current practices of broker-dealers who internalize much of the market’s retail order flow. Additionally, the Exchanges represent that the fees and credits they would implement as part of the Program would replicate the current structure between over-the-counter internalization venues and retail order flow providers.<sup>25</sup>

## 2. Impact on the Sub-Penny Rule

A number of commenters raised concerns about the proposed Program’s use of sub-penny price improvement for retail order flow, and its implications with respect to the Sub-Penny Rule (Rule 612) of Regulation NMS.<sup>26</sup> One commenter noted that by accepting and ranking non-displayed orders in sub-penny increments, the proposals could discourage liquidity by allowing “dark” liquidity to step ahead of posted limit orders for only a trivial amount.<sup>27</sup> The same commenter observed that allowing non-displayed liquidity to gain an execution advantage over posted limit orders for trivial per share amounts could result in wider bid-ask spreads.<sup>28</sup>

Other commenters articulated similar concerns about the protection of public limit orders and public price discovery,<sup>29</sup> and one commenter stated that the proposals might lead to a

potential increase in sub-penny trading.<sup>30</sup> In addition, one commenter pointed out the potential technical systems and capacity issues that could result from effectively reducing the minimum price variant from \$.01 to \$.001, thereby substantially increasing the number of price points between each dollar level.<sup>31</sup>

In response, the Exchanges stated that currently, over-the-counter market makers internalize retail order flow at negotiated prices and not at their publicly displayed quotes. The Exchanges believe that this aspect of the market warrants further Commission consideration, but argued that it does not provide independent basis to disapprove the proposals.

The Exchanges also stated that the bulk of commenters’ concerns about non-displayed liquidity stepping ahead of displayed limit orders for insignificant amounts are misguided. According to the Exchanges, the Commission’s stated guidance with respect to the Sub-Penny Rule concerns market professionals using displayed orders to gain execution priority over customer limit orders. The Exchanges distinguished the proposed Program from such concerns by noting that the Retail Liquidity Identifier would not be priced and Retail Price Improvement Orders would not be displayed. Accordingly, the Exchanges contend that the Program would limit its sub-penny activity to sub-penny executions, and they cite to a statement in the Regulation NMS adopting release articulating the Commission’s belief that sub-penny executions do not raise the same concerns as displayed sub-penny quotes. Similarly, in response to comments about the consequences of moving the “tick size” to \$0.001, the Exchanges stated that the “tick size” would not in fact be altered because the sub-penny components of the Program would not be displayed.

Finally, in response to the concern that the proposals might lead to more sub-penny trading, the Exchanges stated that they do not anticipate such a result. Instead, the Exchanges stated their belief that the proposals would likely reallocate existing retail order market share, which the Exchanges stated that is already subject to “regular” sub-penny executions due to current internalization agreements. Moreover, the Exchanges further stated that if the proposals led to additional sub-penny executions for retail order flow, then it would benefit the market as retail

investors would be receiving greater price improvement than they are today.

## 3. Fair Access

Commenters also highlighted several elements of the Program that potentially implicate the Commission’s rules governing fair access. First, several commenters raised questions about whether the proposals would, in essence, create a private market. Some commenters wrote that the proposed segmentation of retail order flow would amount to unfair discrimination,<sup>32</sup> for example, by creating trading interest that would not be accessible by institutional investors.<sup>33</sup> One commenter suggested that the proposed Program would be akin to operating a limited access dark pool that could have the effect of creating a two-tiered market.<sup>34</sup> Relatedly, some commenters took issue with the proposals to the extent that the Retail Liquidity Identifier would be disseminated only through a proprietary data feed rather than the public market data stream.<sup>35</sup> These commenters felt that limiting dissemination of the Retail Liquidity Identifier to a proprietary data feed could unfairly harm small firms who do not pay for the proprietary feed<sup>36</sup> or create a private, two-tiered market where those who can afford the proprietary feed receive the best prices.<sup>37</sup>

The Exchanges responded that the proposals do not create a fair access issue because the Retail Liquidity Identifier does not satisfy the definition of “quotation” under Regulation NMS. The Exchanges stated their belief that the Retail Liquidity Identifier is not a protected “quotation” because a “quotation” is, by definition, a “bid or an offer,”<sup>38</sup> terms which are in turn defined as the price “communicated by a member of a national securities exchange or member of a national securities association to any broker or dealer, or to any customer, at which it is willing to buy or sell one or more round lots of an NMS security, either as

<sup>32</sup> See CFA Institute Letter and Hudson River Trading Letter. At least one commenter took the opposite view and supported market participant segmentation programs so long as such segmentation is done in an objective and transparent manner. See UBS Letter.

<sup>33</sup> See SIFMA Letter.

<sup>34</sup> See Knight Letter.

<sup>35</sup> See SIFMA Letter and BATS Letter. As noted below, the Exchanges amended their proposals to indicate their intent to disseminate the Retail Liquidity Identifier through the public data feed as soon as practicable.

<sup>36</sup> See SIFMA Letter.

<sup>37</sup> See BATS Letter.

<sup>38</sup> See Exchanges’ Response Letter (citing 17 CFR 242.600(b)(62)).

<sup>23</sup> See Knight Letter and SIFMA Letter.

<sup>24</sup> See Angel Letter. Expressing similar general concerns but not offering specific comment on the proposal, one commenter urged the Commission to exercise caution when considering expert testimony offered by for-profit industry participants as it relates to market structure regulation. See Themis Letter.

<sup>25</sup> See also UBS Letter (stating that the proposed programs would not necessarily lead to more sub-penny activity, but would rather shift some of that activity from the over-the-counter markets to the Exchanges).

<sup>26</sup> See 17 CFR 242.612.

<sup>27</sup> See Angel Letter.

<sup>28</sup> *Id.*

<sup>29</sup> See Voorhies Letter; Joseph Letter; Fournier Letter; PairCo Letter; Wollin Letter; Great Mountain Capital Letter; Koch Letter; CFA Institute Letter; Green Letter; Bright Trading Letter; TD Ameritrade Letter; Kenney Letter; Parsons Letter; and BATS Letter.

<sup>30</sup> See TD Ameritrade Letter.

<sup>31</sup> See Knight Letter.

principal or agent, but shall not include indications of interest.”<sup>39</sup> The Exchanges stated their belief that the Retail Liquidity Identifier falls beyond the definition of “bid” or “offer” because the identifier would not contain a price. According to the Exchanges, there would be no fairness issue in signifying the presence of liquidity by distributing the Retail Liquidity Identifier through a proprietary data feed, especially because participation in the proposed program would be discretionary, likely reduce message traffic from “pinging,” and potentially stimulate additional price competition to the benefit of retail investors. However, in response to concerns about the scope of the Retail Liquidity Identifier’s dissemination, the Exchanges amended the proposals to state that the identifier would be available through the Consolidated Quotation System as soon as practicable.

Another fair access-related issue raised by the commenters relates to the clarity and transparency of certain defined terms in the proposals. Specifically, some commenters expressed concern that under the proposals, the Exchanges would have too much discretion to certify or approve Retail Member Organizations and Retail Liquidity Providers, creating the potential for discriminatory treatment.<sup>40</sup> Two commenters also stated that the definition of “Retail Order,” which relies on the representation of the broker sending the order, may not be sufficiently clear,<sup>41</sup> and one commenter noted that the definition may impose too great of an administrative burden.<sup>42</sup>

The Exchanges responded that they would continually monitor and evaluate all aspects of the Retail Member Organization certification process during the pilot period. The Exchanges disagreed that the definition of “Retail Order” and the Retail Member Organization certification process are unclear or not subject to enforcement. According to the Exchanges, the authentication and certification procedures, together with the requirement that Retail Member Organizations have written policies and procedures to assure that they only submit qualifying retail orders, would result in reliable identification and segmentation of retail order flow. The

Exchanges further stated that the proposals would be subject to regulatory review by FINRA pursuant to a regulatory services agreement with the Exchanges.

The commenters also raised issues related to access fees. One commenter suggested that the appropriate amount of access fees would need to be revisited if the “tick size” is reduced from \$.01 to \$.001 because with a tenth of a penny spread, the maximum allowable fee of \$.003 per share would have the effect of increasing the economic spread by 600%.<sup>43</sup> Another commenter noted that the proposals could open the door to revisiting whether access fees may be included in quotes, assuming the Program leads to sub-penny quotations.<sup>44</sup> Finally, one commenter questioned whether the proposals would result in true price competition because non-Retail Liquidity Providers would most likely not be able to quote aggressively as a result of being charged higher access fees for executions with Retail Orders.<sup>45</sup>

The Exchanges responded that approval of the proposals does not require reexamination of any access fee issue. The Exchanges noted that there would be no visible prices disseminated as part of the program and stated their belief that the proposals would not use any “quotes” subject to the Commission’s fair access rules. The Exchanges also expressed their belief that a broker’s obligations under Regulation NMS would not require it to route a retail order to the Exchanges to interact with a Retail Price Improvement Order. The Exchanges stated further that the proposals comport with the principles behind the Commission’s access rules because the Exchanges intend to welcome broad participation in the Program.

#### 4. Best Execution and Order Protection

Several commenters took the position that the Program would complicate broker-dealers’ best execution duties. According to one commenter, the Exchanges’ dissemination of the Retail Liquidity Identifier would raise a number of issues, including whether broker-dealers would be required to route to the Exchanges when they see a Retail Liquidity Identifier; whether, if other exchanges were to adopt similar proposals and disseminate flags similar to the Retail Liquidity Identifier, a broker-dealer would be required to sweep all liquidity inside the spread before executing at the NBBO; whether

the Exchanges would be required to route Retail Orders they receive to other market centers if those away markets offered the possibility of further price improvement; and whether broker-dealers would be required to subscribe to the Exchanges’ proprietary feed to be able to receive the Retail Liquidity Identifier.<sup>46</sup>

Another commenter questioned whether, if other exchanges were to adopt competing programs and disseminate liquidity interest flags over their proprietary feeds, a broker-dealer would be required to subscribe to each proprietary feed in order to fill its best execution obligations.<sup>47</sup> Relatedly, another commenter stated that the proposals would result in confusion among broker-dealers unsure of how the dissemination of the Retail Liquidity Identifier would affect their smart order router programming.<sup>48</sup> Finally, one commenter suggested that FINRA’s best execution and interpositioning rules would need to be updated to reflect the fact that Retail Liquidity Identifiers would be widely disseminated yet not accessible by non-retail clients.<sup>49</sup>

The Exchanges responded that they believe the proposals do not raise any best execution challenges that are not already confronted by broker-dealers in the current market environment. The Exchanges stated that best execution is a facts and circumstances determination and requires many factors to be considered.<sup>50</sup>

One commenter also raised related concerns about the proposals’ potential impact on broker-dealer obligations under FINRA Rule 5320, also known as the “Manning” rule.<sup>51</sup> FINRA Rule 5320 generally prohibits broker-dealers from trading ahead of their customer orders. The commenter noted that firms that both offer Retail Price Improvement Orders and accept customer orders will likely find themselves frequently in a position where they must fill the customer order at a loss, assuming their Retail Price Improvement Orders get executed before the customer order.<sup>52</sup>

In response to this comment, the Exchanges stated their position that the Manning obligations of a Retail Liquidity Provider would be no different from the obligations on an

<sup>46</sup> See Knight Letter.

<sup>47</sup> See BATS Letter.

<sup>48</sup> See SIFMA Letter.

<sup>49</sup> See UBS Letter.

<sup>50</sup> See Exchanges’ Response Letter (citing Securities Exchange Act Release No. 43590 (November 17, 2000), 65 FR 75414 (December 1, 2000) (“Disclosure of Order Execution and Routing Practices” Adopting Release)).

<sup>51</sup> See Knight Letter.

<sup>52</sup> See *id.*

<sup>39</sup> *Id.* (citing 17 CFR 242.600(b)(8)).

<sup>40</sup> See Hudson River Trading Letter and BATS Letter.

<sup>41</sup> See Hudson River Trading Letter and Knight Letter.

<sup>42</sup> See Knight Letter.

<sup>43</sup> See Knight Letter.

<sup>44</sup> See SIFMA Letter.

<sup>45</sup> See BATS Letter.

over-the-counter market maker that internalizes orders. The Exchanges stated that over-the-counter market makers commonly rely on the “no-knowledge” exception contained in Supplementary Material .02 of FINRA Rule 5320 to separate their proprietary trading from their handling of customer orders. The Exchanges expressed their view that this exception should be equally applicable to Retail Liquidity Providers participating in the Program.

#### IV. Proceedings To Determine Whether To Disapprove SR-NYSE-2011-55 and SR-NYSEAmex-2011-84 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>53</sup> to determine whether the proposals should be disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposals. Institution of disapproval proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described in greater detail below, the Commission seeks and encourages interested persons to provide additional comment on the proposals.

Pursuant to Section 19(b)(2)(B),<sup>54</sup> the Commission is providing notice of the grounds for disapproval under consideration. In particular, Section 6(b)(5) of the Act<sup>55</sup> requires that the rules of an exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. In addition, Section 6(b)(5) prohibits the rules of an Exchange from being designed to permit unfair discrimination between customers, issuers, brokers, or dealers. The rules of an Exchange also must not, absent an exemption, violate the Sub-Penny Rule (Rule 612) of Regulation NMS which, among other things, prohibits an exchange from displaying, ranking, or accepting a bid or offer in an NMS stock priced in an increment smaller than \$0.01 if such bid or offer is priced equal to or greater than \$1.00 per share.<sup>56</sup>

According to the Exchanges, the proposals are designed to attract

additional retail order flow to the Exchanges and provide the potential for price improvement to retail orders. However, the proposals also raise novel market structure issues that warrant further comment and Commission consideration.

For example, as noted above, the proposals are inconsistent with the Sub-Penny Rule because they contemplate the Exchanges accepting and ranking orders in securities priced at \$1.00 or more per share in sub-penny increments, and the Exchanges separately have requested an exemption from that Rule. In addition, the proposals would create a new exchange order type—the Retail Price Improvement Order—that is available only to a subset of market participants, namely Retail Member Organizations. While the Exchanges state that the proposals are designed to attract retail orders to the Exchanges and provide the potential for price improvement to retail orders, the Exchanges define the “Retail Order” that is permitted to interact with Retail Price Improvement Orders as including not only orders that originate from a natural person, but also broker-dealer proprietary orders that liquidate positions acquired from internalizing orders that originate from natural persons. Thus, under the proposals, the connection between the “Retail Order” that is entitled to execute with sub-penny price improvement against Retail Price Improvement Orders and the original retail investor order may be attenuated, and under these circumstances it is unclear whether the benefit of the sub-penny price improvement ultimately would reach the retail investor. Accordingly, given the breadth of the proposed definition of a “Retail Order,” the Commission believes questions are raised as to the scope of the requested exemption under the Sub-Penny Rule, and whether the Exchanges have fairly and reasonably determined the subset of market participants that would be allowed to access Retail Price Improvement Orders.

In addition, the proposals do not describe with precision the attributes of the Retail Liquidity Identifier that would be disseminated when a Retail Price Improvement Order exists. Depending on those details, the Retail Liquidity Identifier could fall within the definition of “bid or offer” in Rule 600(b)(8) of Regulation NMS, which would implicate Rule 602 of Regulation NMS,<sup>57</sup> also known as the Quote Rule. Rule 602 generally requires that a national securities exchange collect, process, and make available to venders

the best bid, the best offer, and aggregate quotation sizes for each NMS security traded on the exchange. Accordingly, the Commission believes the Exchanges should provide additional detail regarding the proposed Retail Liquidity Identifier, to allow the Commission and commenters to assess whether the Quote Rule is implicated and, if so, to understand whether the Exchanges intend to comply with or seek an exemption from some or all of its requirements.

The Commission believes that these concerns raise questions as to whether the Exchanges’ proposals are consistent with the requirements of the Section 6(b)(5) of the Act, including whether they would promote just and equitable principles of trade, perfect the mechanism of a free and open market and a national market system, protect investors and the public interest, and not permit unfair discrimination. The Commission also believes questions are raised as to whether, given the breadth of the definition of “Retail Order” in the Exchanges’ proposals, an exemption for the Program from the Sub-Penny Rule would be in the public interest and consistent with the protection of investors.

#### V. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the concerns identified above, as well as any others they may have with the proposals. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is inconsistent with Section 6(b)(5) or any other provision of the Act, or the rules and regulation thereunder. Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>58</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule changes should be

<sup>53</sup> Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Public Law 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

<sup>53</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>54</sup> See *id.*

<sup>55</sup> 15 U.S.C. 78f(b)(5).

<sup>56</sup> 17 CFR 242.612.

<sup>57</sup> 17 CFR 242.602.

disapproved by March 5, 2012. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by March 19, 2012.

Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NYSE-2011-55 or SR-NYSEAmex-2011-84 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSE-2011-55 or SR-NYSEAmex-2011-84. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer to File Number SR-NYSE-2011-55 or SR-NYSEAmex-2011-84 and should be submitted on or before March 5, 2012. Rebuttal comments should be submitted by March 19, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>59</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

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**BILLING CODE 8011-01-P**

## **SECURITIES AND EXCHANGE COMMISSION**

**[Release No. 34-66350; File No. SR-NYSEArca-2012-14]**

### **Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Amending Commentary .05 to NYSE Arca Rule 6.4 To Allow Trading of Options on iShares<sup>®</sup> Silver Trust<sup>1</sup> and United States Oil Fund at \$0.50 Strike Price Intervals Where the Strike Price Is Less Than \$75**

February 7, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> notice is hereby given that, on February 6, 2012, NYSE Arca, Inc. (the "Exchange" or "NYSE Arca") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange has designated the proposed rule change as constituting a non-controversial rule change under Rule 19b-4(f)(6) under the Act,<sup>4</sup> which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### **I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The Exchange proposes to amend Commentary .05 to NYSE Arca Rule 6.4 to allow trading of options on iShares<sup>®</sup> Silver Trust<sup>5</sup> and United States Oil Fund at \$0.50 strike price intervals where the strike price is less than \$75. The text of the proposed rule change is available at the Exchange, the Commission's Public Reference Room, and [www.nyse.com](http://www.nyse.com).

<sup>59</sup> 17 CFR 200.30-3(a)(57).

<sup>1</sup> "iShares<sup>®</sup>" is a registered trademark BlackRock Institutional Trust Company, N.A.

<sup>2</sup> 15 U.S.C. 78s(b)(1).

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> "iShares<sup>®</sup>" is a registered trademark BlackRock Institutional Trust Company, N.A.

#### **II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

##### *A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change*

###### 1. Purpose

The purpose of this filing is to amend Commentary .05 of Rule 6.4 to allow trading of options on iShares<sup>®</sup> Silver Trust ("SLV" or "SLV Trust") and United States Oil Fund ("USO" or "USO Fund") at \$0.50 strike price intervals where the strike price is less than \$75.

###### The Underlying ETFs

Two popular exchange traded funds ("ETFs"), which are known on the Exchange as Exchange-Traded Fund Shares, underlie SLV and USO options.<sup>6</sup> SLV and USO options are currently traded on several exchanges.<sup>7</sup>

The iShares<sup>®</sup> Silver Trust is a grantor trust that is designed to provide a vehicle for investors to own interests in silver. The purpose of the SLV Trust is to own silver transferred to the trust in exchange for shares that are issued by the trust. Each of such shares represents a fractional undivided beneficial interest in the net assets of the SLV Trust. The objective of the SLV Trust is for the value of the iShares<sup>®</sup> to reflect, at any given time, the price of silver owned by the trust at that time.

The United States Oil Fund is a domestic exchange traded security designed to track the movements of light, sweet crude oil that is known as West Texas Intermediate. The investment objective of the USO Fund is for the changes in percentage terms of

<sup>6</sup> As of July 31, 2011, the average daily volume ("ADV") over the previous three calendar months was 60,087,539 for SLV and 13,881,380 for USO.

<sup>7</sup> These exchanges include, in addition to NYSEArca: NYSEAmex ("Amex"), BATS Global Markets ("BATS"), Boston Options Exchange ("BOX"), Chicago Board Options Exchange ("CBOE"), C2 Options Exchange ("C2"), International Securities Exchange ("ISE"), NASDAQ OMX PHLX ("PHLX") and NASDAQ Options Exchange ("NOM").