

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-79830; File No. SR-NYSEMKT-2016-120]

### Self-Regulatory Organizations; NYSE MKT LLC; Order Granting Accelerated Approval of a Proposed Rule Change To Amend NYSE MKT Rule 971.1NY and Make Permanent the Aspects of Customer Best Execution Auction That Are Subject to a Pilot

January 18, 2017.

#### I. Introduction

On December 16, 2016, NYSE MKT LLC (“Exchange” or “NYSE MKT”) filed with the Securities and Exchange Commission (“Commission”), pursuant to the provisions of 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 amend certain eligibility requirements of NYSE MKT Rule 971.1NY (“Rule 971.1NY”) that govern its Customer Best Execution Auction (“CUBE” or “CUBE Auction”) and to make permanent the provisions of Rule 971.1NY that currently operate on a pilot basis. The proposed rule change was published for comment in the **Federal Register** on December 23, 2016.<sup>3</sup> The Commission received no comments regarding the proposal. This order approves the proposed rule change on an accelerated basis.

#### II. Description of the Proposal

CUBE is an electronic crossing mechanism for single-leg orders that is designed to provide the opportunity for price improvement for paired orders of any size.<sup>4</sup> To commence a CUBE Auction, an ATP Holder (“Initiating Participant”) may electronically submit for execution a limit order that it represents as agent on behalf of a public customer, broker dealer, or any other entity (“CUBE Order”). The Initiating Participant agrees to guarantee the execution of the CUBE Order by submitting a contra-side order representing principal interest or interest that it has solicited to trade with the CUBE Order at a specified price (“single stop price”) or by utilizing the auto-match or auto-match limit features set forth in Rule 971.1NY.<sup>5</sup>

Two aspects of the CUBE were approved by the Commission on a pilot

basis (“CUBE Pilot”): (1) Rule 971.1NY(b)(1)(B), which establishes the permissible range of executions for CUBE Auctions for fewer than 50 contracts;<sup>6</sup> and (2) Rule 971.1NY(b)(8), which establishes the minimum size for a CUBE Auction as one contract. In connection with the CUBE Pilot, the Exchange has provided certain data to the Commission to provide supporting evidence that, among other things, there is meaningful competition for all size orders within the CUBE Auction and that there is an active and liquid market functioning on the Exchange outside of the CUBE Auction.<sup>7</sup> The CUBE Pilot is currently set to expire on January 18, 2017.<sup>8</sup>

As described more fully below, the Exchange proposes to amend Rule 971.1NY to provide that CUBE Orders for fewer than 50 contracts entered when the NBBO is \$0.01 wide will be rejected, unless the Initiating Participant guarantees the CUBE Order price improvement. With this proposed modification to CUBE Auctions for fewer than 50 contracts, the Exchange proposes that the CUBE Pilot be made permanent. In support of its proposal, the Exchange has provided the Commission with data for CUBE executions for the period from January through June 2015 (“CUBE Data”),<sup>9</sup> as analyzed in summary below.

##### A. Modification of CUBE Eligibility Requirements

The Exchange proposes to modify Rule 971.1NY to require price improvement for CUBE Orders for fewer than 50 contracts when the NBBO is \$0.01 wide. Currently, Rule 971.1NY(b)(6) provides that CUBE Orders for fewer than 50 contracts that are submitted when the Exchange best bid and offer (“BBO”) is \$0.01 wide will be rejected. This requirement will be retained. The Exchange, however, proposes to amend Rule 971.1NY(b)(6)

<sup>6</sup> Rule 971.1NY(b)(1) sets forth the permissible range of executions for a CUBE Order. Generally, a CUBE Order for 50 or more contracts may be executed at a price equal to or better than the National Best Bid and Offer (“NBBO”) on the contra side of the market and equal to or better than the NBBO on its own side of the market as long as there is no Customer order in the Exchange’s Consolidated Book at that price on that side. See Rule 971.1NY(a) and (b)(1)(A). Pursuant to the CUBE Pilot, a CUBE Order for fewer than 50 contracts is subject to a tighter range of permissible executions. Specifically, if the CUBE Order is for fewer than 50 contracts, the execution price must be at least \$0.01 better than any displayed interest in the Exchange’s Consolidated Book. See Rule 971.1NY(a) and (b)(1)(B).

<sup>7</sup> See Commentary .01 to Rule 971.1NY.

<sup>8</sup> See Securities Exchange Act Release No. 78324 (July 14, 2016), 81 FR 47196 (July 20, 2016) (SR-NYSEMKT-2016-69).

<sup>9</sup> See Exhibit 3 to SR-NYSEMKT-2016-120.

to add that CUBE Orders for fewer than 50 contracts entered when the NBBO is \$0.01 wide also will be rejected (*i.e.*, whether or not the Exchange BBO is the same as the NBBO)—unless the Initiating Participant guarantees the execution of the CUBE Order to buy (sell) at a price that is equal to the NBO minus \$0.01 (NBB plus \$0.01), utilizing a single stop price, auto-match, or auto-match limit as specified in Rule 971.1NY(c)(1)(A)–(C).<sup>10</sup>

Although the Exchange continues to believe that the CUBE Auction provides opportunities for price improvement of CUBE Orders of fewer than 50 contracts when the NBBO has a bid/ask differential of \$0.01, the Exchange states that the data have not demonstrated significant price improvement in this narrow circumstance.<sup>11</sup> The Exchange notes that between January and June 2015, a total of 171,822 contracts were executed in CUBE Auctions for fewer than 50 contracts when the NBBO had a bid/ask differential of \$0.01.

According to the Exchange, only 1,660 of those contracts received price improvement of \$0.01. Thus, consistent with the Exchange’s view that price improvement auctions should provide price improvement, particularly for small orders, the Exchange is proposing to require that Initiating Participants guarantee price improvement for CUBE Orders for fewer than 50 contracts when the NBBO is \$0.01 wide; otherwise, the CUBE Order will be rejected.

##### B. Making the CUBE Pilot Permanent

The Exchange has analyzed the CUBE Data and believes that it indicates that there is meaningful competition in CUBE Auctions for all size orders, regardless of the size of the order or the bid/ask differential of the NBBO.<sup>12</sup> Specifically, between January and June 2015, a total of 4,493,429 contracts were executed in CUBE Auctions. According to the Exchange, Market Makers and other participants submitted competitive bids and offers during the CUBE Auction’s Response Time Interval, and thereby indicated interest in participating in CUBE Auction trades. In addition, the Exchange believes that the allocation of orders executed in CUBE Auctions (either at a single price

<sup>10</sup> The proposal would not alter the separate price improvement requirement set forth in Rule 971.1NY(b)(1)(B), which, read in conjunction with Rule 971.1NY(a), establishes that the range of permissible execution prices for CUBE Orders of fewer than 50 contracts would be equal to or better than the NBBO and at least \$0.01 better than any displayed interest in the Exchange’s Consolidated Book.

<sup>11</sup> See Notice, *supra* note 3 at 94439. See also Exhibit 3 to SR-NYSEMKT-2016-120.

<sup>12</sup> See Notice, *supra* note 3 at 94439.

<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 No. 79599 (December 19, 2016), 81 FR 94437 (“Notice”).

<sup>4</sup> See Rule 971.1NY. See also Securities Exchange Act Release No. 72025 (April 25, 2014), 79 FR 24779 (May 1, 2014) (NYSEMKT-2014-17).

<sup>5</sup> See Rule 971.1NY(c)(1)(A)–(C).

or multiple prices) supports competitive bidding and offering.

The Exchange also believes that the CUBE Data reveals that there is an active and liquid market functioning on the Exchange outside of the CUBE Auction.<sup>13</sup> The Exchange points out that competitive bidding and offering occurs outside of the CUBE Auction and participants can submit bids/offers at improved prices or join a bid or offer (thus improving liquidity at that price) regardless of the bid/ask differential of the NBBO.

As discussed above, the Exchange continues to believe that the CUBE Auction provides opportunities for price improvement of CUBE Orders of fewer than 50 contracts when the NBBO has a bid/ask differential of \$0.01 (for one reason, because the market conditions may change during the CUBE Auction). However, because the data have not demonstrated significant price improvement in this circumstance,<sup>14</sup> the Exchange has proposed to require that Initiating Participants guarantee price improvement for CUBE Orders for fewer than 50 contracts when the NBBO has a bid/ask differential of \$0.01.

The Exchange believes, however, that CUBE Auctions for fewer than 50 contracts have served as a valuable tool in providing price improvement when the NBBO has a bid/ask differential of greater than \$0.01. The Exchange notes that, for CUBE Auctions of fewer than 50 contracts, the CUBE Data indicates that when the NBBO has a bid/ask differential between \$0.02 and \$0.05, contracts executed in CUBE Auctions received, on average, price improvement of \$0.0114, and, in wider markets (*i.e.*, bid/ask differentials greater than \$0.05), contracts executed in CUBE Auctions received, on average, price improvement of more than \$0.0759.<sup>15</sup>

Based on its analysis of the CUBE Data, including the data regarding CUBE Auctions where the NBBO spread is \$0.01, the Exchange believes that the CUBE Auction, as modified by the proposed revision to Rule 971.1NY(b)(6), would allow the Exchange to continue to provide meaningful competition for all size orders—including small orders—as well as to continue to offer an active and liquid market outside of the CUBE

Auction.<sup>16</sup> Thus, the Exchange believes that it would be beneficial to customers and to the options market to make permanent the CUBE Pilot, with the modification for CUBE Auctions of fewer than 50 contracts where the NBBO spread is \$0.01. Once permanent, the CUBE Auction would continue to accept orders of fewer than 50 contracts, provided such orders comply with amended Rule 971.1NY(b)(6), which should continue to attract small orders and promote competition and price improvement opportunities for such CUBE Orders.

### III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, with Section 6(b) of the Act.<sup>17</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>18</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect customers, issuers, brokers and dealers.

As part of its proposal, the Exchange provided summary data on Exhibit 3 of its filing for the period January through June 2015, which the Exchange and Commission both publicly posted on their respective Web sites. Among other things, this data is useful in assessing the level of price improvement in the auction, in particular for orders of fewer than 50 contracts; the degree of competition for order flow in such auctions; and a comparison of liquidity in the auctions with liquidity on the Exchange generally.<sup>19</sup> Based on the data provided by the Exchange, the Commission believes that the Exchange's price improvement auction generally delivers a meaningful opportunity for price improvement to

orders, including orders for fewer than 50 contracts, when the spread in the option is \$0.02 or more. At the same time, as the Exchange has recognized, the data do not demonstrate that such orders have realized significant price improvement when the NBBO has a bid/ask differential of \$0.01.<sup>20</sup> Recognizing this, the Exchange has proposed to amend the auction eligibility requirements to reject any CUBE Order where the NBBO has a bid/ask differential of \$0.01, whether or not the Exchange BBO is the same as the NBBO, unless the Initiating Participant guarantees at least \$0.01 of price improvement.<sup>21</sup>

The Exchange's proposal to modify the auction eligibility requirements for orders of fewer than 50 contracts and seek permanent approval of the CUBE Pilot, as amended with the new provision, will, in the Commission's view, promote opportunities for price improvement for such orders when the NBBO is \$0.01 wide, while continuing to provide opportunities for price improvement when spreads are wider than \$0.01.

The Commission believes that, particularly for auctions for fewer than 50 contracts when the bid/ask differential is wider than \$0.01, the data provided by the Exchange support its proposal to make the CUBE Pilot permanent. The data demonstrate that the auction generally provides price improvement opportunities to orders, including orders of retail customers and particularly when the bid/ask differential is wider than \$0.01, that there is meaningful competition for orders on the Exchange; and that there exists an active and liquid market functioning on the Exchange outside of the auction.<sup>22</sup> The Commission further believes that the proposed revision to the eligibility requirements for orders of fewer than 50 contracts with respect to circumstances when the NBBO is no more than \$0.01 wide should help to enhance the operation of the auction by providing meaningful opportunities for price improvement in such circumstances, and should benefit investors and others in a manner that is consistent with the Act. Thus, the Commission has determined to approve the Exchange's proposed revisions to Rule 971.1NY(b)(6) and Commentary .01 to Rule 971.1NY and to approve the

<sup>13</sup> From January through June 2015, the Exchange executed a total of 152,193,516 contracts outside of CUBE Auctions, which the Exchange believes is indicative of an active and liquid market functioning on the Exchange outside of CUBE Auctions.

<sup>14</sup> See Notice, *supra* note 3 at 94439.

<sup>15</sup> See *id.* See also Exhibit 3 to SR-NYSEMKT-2016-120.

<sup>16</sup> See Notice, *supra* note 3 at 94439.

<sup>17</sup> 15 U.S.C. 78f(b). In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>18</sup> 15 U.S.C. 78f(b)(5).

<sup>19</sup> See Exhibit 3 to SR-NYSEMKT-2016-120.

<sup>20</sup> See Notice, *supra* note 3 at 94439.

<sup>21</sup> The Exchange will continue to reject CUBE Orders for fewer than 50 contracts when the BBO is \$0.01 wide. See Rule 971.1NY(b)(6).

<sup>22</sup> See Exhibit 3 to SR-NYSEMKT-2016-120.

CUBE Pilot, as proposed to be modified, on a permanent basis.

#### IV. Accelerated Approval of Proposed Rule Change

The Exchange has requested that the Commission find good cause for approving the proposed rule change prior to the 30th day after publication of the notice thereof in the **Federal Register**. The Exchange stated that accelerated approval of its proposal would allow the applicable rules to remain in effect following the expiration of the CUBE Pilot on January 18, 2017, which would avoid any potential investor confusion that could result from a suspension or temporary interruption in the CUBE Pilot. For this reason, the Commission believes that good cause exists for accelerated approval of the proposed rule change. The Commission further notes that the original proposal was subject to a 21 day comment period and no comments were received on the proposal. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>23</sup> to approve the proposed rule change prior to the 30th day after the date of publication of the notice of filing thereof in the **Federal Register**.

#### V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>24</sup> that the proposed rule change (SR-NYSEMKT-2016-120), be and hereby is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>25</sup>

**Eduardo A. Aleman,**  
Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-79833; File No. S7-27-11]

### Order Extending Certain Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection With the Revision of the Definition of “Security” To Encompass Security-Based Swaps and Request for Comment

January 18, 2017.

#### I. Introduction

The Securities and Exchange Commission (“Commission”) is (i) extending certain temporary exemptive relief originally provided by the Commission in connection with the revision of the definition of “security” in the Securities Exchange Act of 1934 (“Exchange Act”) to encompass security-based swaps (“Temporary Exemptions”);<sup>1</sup> and (ii) requesting comment on whether continuing exemptive relief is necessary beyond February 5, 2018. These temporary exemptions were provided by the Commission on July 1, 2011 and most recently extended by the Commission on February 5, 2014.<sup>2</sup> Certain of the Temporary Exemptions are set to expire on February 5, 2017.<sup>3</sup>

The expiration dates in the Extension Order distinguished between: (i) The Temporary Exemptions related to pending security-based swap rulemakings (“Linked Temporary Exemptions”); and (ii) the Temporary Exemptions that generally were not directly related to a specific security-based swap rulemaking (“Unlinked

Temporary Exemptions”). The expiration dates for the Linked Temporary Exemptions established by the Extension Order were the compliance dates for the specific rulemakings to which they were “linked,” and the expiration date for the Unlinked Temporary Exemptions was three years following the effective date of the Extension Order (*i.e.*, February 5, 2017), or such time that the Commission issues an order or rule determining whether continuing exemptive relief is appropriate for security-based swaps with respect to any such Unlinked Temporary Exemptions.

As described in more detail below, the Commission is extending the expiration date for the Unlinked Temporary Exemptions until February 5, 2018. This approach provides the Commission flexibility to determine whether continuing relief should be provided for any Unlinked Temporary Exemptions while the Commission continues to consider the relevant rules mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>4</sup> This release has no effect on the expiration dates for the Linked Temporary Exemptions.<sup>5</sup>

#### II. Discussion

##### A. Background

Title VII of the Dodd-Frank Act amended the definition of “security” under the Exchange Act to expressly encompass security-based swaps.<sup>6</sup> The expansion of the definition of the term “security” changed the scope of the Exchange Act regulatory provisions that apply to security-based swaps and

<sup>1</sup> See Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revisions of the Definition of “Security” to Encompass Security-Based Swaps, Exchange Act Release No. 64795 (Jul. 1, 2011), 76 FR 39927 (Jul. 7, 2011) (“Exchange Act Exemptive Order”).

<sup>2</sup> See Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of “Security” to Encompass Security-Based Swaps, and Request for Comment, Exchange Act Release No. 71485 (Feb. 5, 2014), 79 FR 7731 (Feb. 10, 2014) (“Extension Order”); see also Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Exchange Act Release No. 67453 (Jul. 18, 2012), 77 FR 48207 (Aug. 13, 2012) (“Product Definitions Adopting Release”) (extending the expiration date of the Temporary Exemptions to February 11, 2013); and Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of “Security” to Encompass Security-Based Swaps, and Request for Comment, Exchange Act Release No. 68864 (Feb. 7, 2013), 78 FR 10218 (Feb. 13, 2013) (“2013 Extension Order”) (extending the expiration date to February 11, 2014).

<sup>3</sup> See Extension Order.

<sup>4</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) (“Dodd-Frank Act”).

<sup>5</sup> The Commission has already addressed some of the Linked Temporary Exemptions. For example, on June 8, 2016, the Commission adopted new rules for trade acknowledgement and verification of security-based swap transactions. See Trade Acknowledgement and Verification of Security-Based Swap Transactions, Exchange Act Release No. 78011 (Jun. 8, 2016), 81 FR 39807 (Jun. 17, 2016) (“Trade Acknowledgment Release”). In that release, the Commission described the application of Exchange Act Rule 10b-10 to transactions in security-based swaps and noted that the Linked Exemption relating to Exchange Act Rule 10b-10 would expire upon the compliance date of the new Rule 15Fi-2. See Trade Acknowledgement Release at 39824-25, note 189.

<sup>6</sup> See Section 761(a)(2) of the Dodd-Frank Act (amending Section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)). The provisions of Title VII generally became effective on July 16, 2011 (360 days after the enactment of the Dodd-Frank Act) (the “Effective Date”), unless a provision required a rulemaking, in which case the provision would go into effect “not less than” 60 days after publication of the related final rules in the **Federal Register** or on July 16, 2011, whichever is later. See Section 774 of the Dodd-Frank Act.

<sup>23</sup> 15 U.S.C. 78s(b)(2).

<sup>24</sup> 15 U.S.C. 78s(b)(2).

<sup>25</sup> 17 CFR 200.30-3(a)(12).