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SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-71176; File No. SR-NYSEArca-2013-107)

December 23, 2013

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Granting Approval to Proposed Rule
Change to Establish a Retail Liquidity Program on a Pilot Basis for a Period of One Year from
the Date of Implementation and Granting Request For a Limited Exemption from Rule 612 of
Regulation NMS

I.   Introduction

On October 22, 2013, NYSE Arca, Inc. ("NYSE Arca" or "Exchange") filed with the

Securities and Exchange Commission ("Commission") pursuant to Section 19(b)(1) of the

Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] 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. The proposed rule change was published for comment in the Federal

Register on November 13, 2013.[3] The Commission did not receive any comments on the

proposed rule change. In connection with the proposal, the Exchange requested exemptive relief

from Rule 612 of Regulation NMS,[4] which, among other things, prohibits a national securities

exchange from accepting or ranking orders priced greater than $1.00 per share in an increment

smaller than $0.01.[5]

This order approves the proposed rule change and grants the exemption from the Sub-

Penny Rule sought by the Exchange in relation to the proposed rule change.

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1   15 U.S.C. 78s(b)(1).

2   17 CFR 240.19b-4.

3   See Securities Exchange Act Release No. 70824 (Nov. 6, 2013), 78 FR 68116 ("Notice").

4   17 CFR 242.612 ("Sub-Penny Rule").

5   See Letter from Janet McGinness, EVP & Corporate Secretary, NYSE Euronext, to
        Elizabeth M. Murphy, Secretary, Commission (Oct. 11, 2013) ("Request for Sub-Penny
        Rule Exemption").

II.   Description of the Proposals

        Overview

        The Exchange is proposing a 12-month pilot program to attract additional retail order

flow to the Exchange, while also providing the potential for price improvement to this order

flow. The Program would be limited to trades occurring at prices equal to or greater than $1.00

per share.[6] The Program would include NYSE Arca-listed securities and UTP Securities, but it

would exclude NYSE-listed securities.

        Under the proposed Program, a new class of market participants called Retail Liquidity

Providers ("RLPs") would be able to provide potential price improvement to designated retail

orders by submitting a Retail Price Improvement Order ("RPI Order"), which would be a non-

displayed order that is priced better than the Exchange's best protected bid or offer ("PBBO").[7]

RLPs could receive special execution fees for executing against retail orders in exchange for

satisfying certain specified quoting obligations.[8] Other Exchange member organizations[9] would

be allowed, but not required, to submit RPI Orders. When there is an RPI Order in a particular

security, the Exchange would disseminate an indicator, called the Retail Liquidity Identifier, to

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[6]   The Exchange notes that certain orders submitted to the Program designated as eligible to
        interact with liquidity outside of the Program – Type 2 Retail Orders, which are discussed
        below – could execute at prices below $1.00 if they do in fact execute against liquidity
        outside of the Program.

[7]   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).

[8]   The Exchange stated in its filing that it would submit a separate proposal to amend its
        Price List to reflect the fees and credits connected to the program.

[9]   NYSE Arca refers to its members as Equity Trading Permit ("ETP") Holders.

indicate that such interest exists. In response to the indicator, a new class of market participants

known as Retail Member Organizations ("RMOs") could submit a new type of order, called a

Retail Order, to the Exchange. A Retail Order would interact, to the extent possible, with

available contra-side RPI Orders and then may interact with other liquidity on the Exchange or

elsewhere, depending on the Retail Order's instructions. The Exchange would approve ETP

Holders to be RLPs or RMOs.

Types of Orders and the Retail Liquidity Identifier

An RPI Order would be non-displayed interest in NYSE Arca-listed securities and UTP

Securities, excluding NYSE-listed (Tape A) securities, that is priced more aggressively than the

PBBO by at least $0.001 per share and that is identified as an RPI Order in a manner prescribed

by the Exchange. RPI Orders would be entered at a single limit price, rather than being pegged

to the PBBO, although an RPI Order could also be designated as a Mid-Point Passive Liquidity

("MPL") Order, in which case the order would re-price as the PBBO changes.[10] RPI Orders

would remain non-displayed and could only execute against Retail Orders.

When an RPI Order priced at least $0.001 better than the Exchange's PBBO for a

particular security is available in the System, the Exchange would disseminate an identifier,

known as the Retail Liquidity Identifier, indicating that such interest exists. The identifier would

be disseminated through the Consolidated Quotation System ("CQS"), the UTP Quote Data

Feed, and the Exchange's proprietary data feed. The identifier would reflect the symbol for a

particular security and the side (buy or sell) of the RPI Order, but it would not include the price

or size of such interest.

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[10]   RPI Orders not designated as MPL Orders would alternatively need to be designated as a
        PL Order. As noted above, supra note 12, MPL and PL Orders are defined in Exchange
        Rule 7.31(h).

A Retail Order would be an agency or riskless principal[11] order that originates from a natural person and is submitted to the Exchange by an RMO, provided that no change is made to the terms of the order with respect to price (except in the case of a market order being changed to a marketable limit order) or side of market and provided that the order does not originate from a trading algorithm or any other computerized methodology. Retail Orders could be entered in sizes that are odd lots, rounds lots, or mixed lots.

Under the proposal, an RMO that submits a Retail Order could choose one of two designations to dictate how that order would interact with available contra-side interest.

First, a Retail Order could interact only with available contra-side RPI Orders, as well as other non-displayed liquidity[12] and displayable odd-lot interest priced better than the PBBO on the opposite side of the Retail Order, excluding contra-side Retail Orders. The Exchange would label this a Type 1 Retail Order, and such an order would not interact with available non-price-improving, contra-side interest in Exchange systems or route to other markets. Portions of a Type 1 Retail Order that are not executed would be cancelled immediately and automatically.

Second, a Retail Order could interact first with available contra-side RPI Orders and other price-improving liquidity, and any remaining portion would be eligible to interact with other interest in the System and, if designated as eligible for routing, would route to other

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[11] In order to qualify as a "Retail Order," a "riskless principal" order must satisfy the criteria set forth in FINRA Rule 5320.03. RMOs that submit riskless principal orders as Retail Orders must maintain supervisory systems to reconstruct such orders in a time-sequenced manner, and the RMOs must submit reports, contemporaneously with the execution of the facilitated orders, that identify such trades as riskless principal.

[12] Such other non-displayed liquidity would include, for example, Passive Liquidity ("PL") Orders and Mid-Point Passive Liquidity ("MPL") Orders. These orders are defined in Exchange Rule 7.31(h). However, any Retail Order could be designated with a "No Midpoint Execution" modifier, pursuant to existing Exchange Rule 7.31(h)(5); an order so designated would not execute against resting MPL Orders but would execute against eligible RPIs that are also designated as MPL Orders.

markets in compliance with Regulation NMS. The Exchange would label this a Type 2 Retail Order. Type 2 orders could be marked as Immediate or Cancel, Day, or Market. A Type 2 IOC order would interact first with available contra-side RPI Orders and other price improving liquidity, excluding contra-side Retail Orders, and then any remaining portion of the Retail Order would be executed as a limit order marked as an IOC, pursuant to Exchange Rule 7.31(e)(2). For Type 2 Day orders, any shares that remain after executing against contra-side RPI Orders or other price-improving liquidity would execute against other liquidity available on the Exchange or be routed to other market centers for execution; any remaining portion of the order would thereafter post to the NYSE Arca Book.[13] Type 2 Market orders would execute first against RPI Orders or other price-improving liquidity, and they would then be executed as a typical Exchange Market Order.[14]

Priority and Allocation

Under proposed NYSE Arca Equities Rule 7.44(l), the Exchange would rank and allocate RPI Orders in a particular security together with all other non-displayed interest according to their price first and then, at any given price point, by their time of entry into the system.[15] Any displayable odd-lot interest priced between the PBBO would be ranked ahead of any RPIs and other non-displayed interest at a given price point.

Following execution against a Retail Order, any remaining unexecuted portion of an RPI Order would remain available to interact with other incoming Retail Orders if the remainder of

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[13] Exchange Rule 1.1(a) defines the "NYSE Arca Book" as "the NYSE Arca Marketplace's electronic file of orders, which contains all the User's orders in each of the Directed Order, Display Order, Working Order and Tracking Order Processes."

[14] The Exchange noted that Type 2 Market orders would be subject to the Exchange's trading collars. See NYSE Arca Equities Rule 7.31(a).

[15] The Exchange sets forth its price-time priority scheme in its Rule 7.36.

the RPI Order were at an eligible price, i.e., better than the PBBO by at least $0.001. Any

remaining unexecuted portion of a Retail Order would cancel, execute, or post to the NYSE Arca

Book in accordance with its order type designation, as explained above and set forth in proposed

Exchange Rule 7.44(k).

Retail Member Organizations

In order to become an RMO, an ETP Holder must conduct a retail business or handle

retail orders on behalf of another broker-dealer. Any ETP Holder that wishes to obtain RMO

status would be required to submit: (1) an application form; (2) an attestation, in a form

prescribed by the Exchange, that substantially all orders submitted by the ETP Holder as Retail

Orders would meet the qualifications for such orders under proposed Exchange Rule 7.44; and

(3) supporting documentation sufficient to demonstrate the retail nature and characteristics of the

applicant's order flow.[16] If the Exchange disapproves the application, it would provide written

notice to the ETP Holder. The disapproved applicant could appeal the disapproval as provided

below or re-apply 90 days after the disapproval notice is issued by the Exchange. An RMO also

could voluntarily withdraw from RMO status at any time by giving written notice to the

Exchange.

The Exchange would require an RMO to have written policies and procedures reasonably

designed to assure that it will only designate orders as Retail Orders if all the requirements of a

Retail Order are met. Such written policies and procedures would have to require the ETP

Holder to exercise due diligence before entering a Retail Order to assure that entry as a Retail

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[16]   For example, a prospective RMO could be required to provide sample marketing
         literature, website screenshots, other publicly disclosed materials describing the retail
         nature of its order flow, and such other documentation and information as the Exchange
         may require to obtain reasonable assurance that the applicant's order flow would meet the
         requirements of the Retail Order definition.

Order is in compliance with the proposed rule and to require the ETP Holder to monitor whether

orders entered as Retail Orders meet the applicable requirements. If an RMO represents Retail

Orders from another broker-dealer customer, the RMO's supervisory procedures must be

reasonably designed to assure that the Retail Orders it receives from the broker-dealer customer

meet the definition of a Retail Order. The RMO must obtain an annual written representation, in

a form acceptable to the Exchange, from each broker-dealer customer that sends it orders to be

designated as Retail Orders. The representation must state that entry of Retail Orders will be in

compliance with the requirements of this rule. The RMO must also monitor whether its broker-

dealer customer's Retail Order flow continues to meet the applicable requirements.[17]

Retail Liquidity Provider Qualifications and Admission

To qualify as an RLP under proposed Exchange Rule 7.44(c), an ETP Holder must be

approved as a Market Maker or Lead Market Maker[18] on the Exchange and demonstrate an

ability to meet the requirements of a being an RLP (discussed below). Moreover, the ETP

Holder must have the ability to accommodate Exchange-supplied designations that identify to the

Exchange RLP trading activity in assigned RLP securities and must have adequate trading

infrastructure and technology to support electronic trading.

An ETP Holder must submit an application with supporting documentation to the

Exchange. Thereafter, the Exchange would notify the ETP Holder as to whether it was approved

as an RLP. More than one member organization could act as an RLP for a security, and an ETP

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[17]   The Exchange represents that it or another self-regulatory organization on behalf of the
        Exchange will review an RMO's compliance with these requirements through an exam-
        based review of the RMO's internal controls. See Notice, supra note 3, 78 FR at 68117
        n.10.

[18]   The requirements for Market Makers are generally set forth in NYSE Arca Equities Rule
        7. The terms "Market Maker" and "Lead Market Maker" are defined in NYSE Arca
        Equities Rule 1.1 (v) and (ccc), respectively.

Holder could act as an RLP for more than one security. An ETP Holder could ask to be assigned certain securities. Once approved, an RLP must establish connectivity with relevant Exchange systems prior to trading.

The Exchange would notify an ETP Holder in writing if the Exchange does not approve that firm's application to become an RLP. The ETP Holder could then request an appeal as provided below. The ETP Holder could also reapply 90 days after the Exchange issues the disapproval notice.

Once approved, an RLP could withdraw by providing notice to the Exchange. The withdrawal would become effective when the Exchange reassigns the securities to another RLP, but 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 RLP would have no further obligations.

Retail Liquidity Provider Requirements

The proposed rule changes would impose several requirements on RLPs. First, under proposed Rule 7.44(f), an RLP could enter, in its role as an RLP, an RPI Order electronically into Exchange systems only in its assigned securities.[19] In order to be eligible for special execution fees,[20] an RLP must maintain RPI Orders that are better than the PBBO at least 5% of the trading day for each assigned security. An RLP would not receive special execution fees during a month in which it had not satisfied its 5% quoting requirement.

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[19]   An RLP could enter RPI Orders into Exchange systems and facilities for securities to which it was not assigned; however, it would be not be doing so in its role as RLP and thus would not be eligible for execution fees that are lower than non-RLP rates for securities to which it was not assigned.

[20]   As noted above, supra note 8, the Exchange plans to submit a separate filing to establish the levels of fees and credits associated with the program.

To calculate the 5% quoting requirement, the Exchange would determine the average percentage of time an RLP maintains an RPI 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 an RLP maintains an RPI Order priced higher than 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 an RLP maintains an RPI Order priced lower than 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 that 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 that month.

The proposal specifies that only RPI Orders entered through the trading day would be used when determining compliance with the 5% quoting requirements. Further, an RLP would have an initial two-month grace period, so that 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 an RLP.

Penalties for Failure to Meet Requirements

The proposal provides for penalties when an RLP or RMPO fails to meet the requirements of the rule.

If an RLP fails to meet the 5% quoting requirements in any assigned security for three consecutive months, the Exchange, in its sole discretion, may: (1) revoke the assignment of any

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or all of the affected securities; (2) revoke the assignment of unaffected securities; or (3) disqualify the ETP Holder from its status as an RLP.[21] If the Exchange moves to disqualify an ETP Holder as an RLP, then the Exchange would notify the ETP Holder in writing one calendar month prior to the determination. Likewise, the Exchange would notify the ETP Holder in writing if the Exchange ultimately determined to disqualify the ETP Holder as an RLP. An RLP that is disqualified may appeal as provided below or reapply.

With respect to RMOs, the Exchange could disqualify an ETP Holder from its RMO status if the Retail Orders submitted by the RMO did not comply with the requirements of the proposed rule. The Exchange would have sole discretion to make such a determination. The Exchange would provide written notice to the RMO when a disqualification determination was made. Similar to a disqualified RLP, a disqualified RMO could appeal as provided below or reapply for RMO status.

Appeal Process

Under the proposal, the Exchange would establish a Retail Liquidity Program Panel to review disapproval or disqualification decisions. An affected ETP Holder would have five business days after notice to request review. If an ETP Holder is disqualified as an RLP and has appealed, the Exchange would stay the reassignment of securities pending completion of the appeal process.

The Panel would consist of the NYSE's Chief Regulatory Officer, or his or her 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 a time frame

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[21] Additionally, as noted above, an RLP that failed to meet its quoting obligations in a given month would not be eligible to receive special execution fees for its RPI Orders for that month.

prescribed by the Exchange. The Panel's decision would constitute final action by the Exchange, and the Panel could modify or overturn any Exchange determinations made under the proposed rule.

Comparison with Existing Retail Programs on Other Markets

As the Exchange noted in its filing, the proposal is based on the New York Stock Exchange's Retail Liquidity Program.[22] It is also shares features with similar retail programs adopted by BATS Y-Exchange ("BYX") [23] and The NASDAQ Stock Market ("NASDAQ").[24]

The Exchange's proposal differs from the NYSE RLP in three key ways. First, the Exchange's proposal would allow all incoming Retail Orders to execute against resting RPI Orders and other resting price improving liquidity, just as the BYX and NASDAQ retail programs do.[25] With the NYSE RLP, in contrast, a Type 1 Retail Order, will interact only with available contra-side RPI Orders and will not interact with other available contra-side interest in the NYSE's systems.[26] Second, the Exchange could provide price improvement to an incoming

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[22] See Securities Exchange Act Release No. 67347 (July 3, 2012), 77 FR 40673 (July 10, 2012) (SR-NYSE-2011-55; SR-NYSEAmex-2011-84) ("NYSE RLP Approval Order"). In the same order, the Commission also approved a nearly identical Retail Liquidity Program for NYSE MKT LLC (which was known as NYSE Amex LLC at the time it filed its proposal). The initial one-year term of the NYSE RLP pilot came to an end on July 31, 2013, and it was extended for a second pilot year, until July 31, 2014. See Securities Exchange Act Release No. 70096 (August 2, 2013), 78 FR 48535 (August 8, 2013).

[23] See Securities Exchange Act Release No. 68303 (Nov. 27, 2012), 77 FR 71652 (Dec. 3, 2012) ("BYX RPI Approval Order").

[24] See Securities Exchange Act Release No. 69837 (Feb. 15, 2013), 78 FR 12397 (Feb. 22, 2013) ("NASDAQ RPI Approval Order").

[25] See BYX Rules 11.24(f)(1) and (2) and NASDAQ Rules 4780(f)(1) and (2) (providing that Retail Orders may execute against both RPIs and other price improving interest).

[26] See NYSE Rule 107C(k)(1). Additionally, pursuant to NYSE Rules 107C(k)(2) and 107C(k)(3), a Type 2 Retail Order and a Type 3 Retail Order can interact with other non-RPI interest in the NYSE systems; however, such interaction only occurs after a Retail Order first executes against RPI Orders.

Retail Order at multiple price levels. This is similar to how the BYX and NASDAQ programs operate, and it differs from the NYSE RLP, which executes an incoming Retail Order at a single clearing price level.[27] Finally, because of technological limitations, the Exchange would not offer the ability for RLPs to enter RPI Orders that track the PBBO, as they often do in the NYSE RLP.[28]

III.   Discussion and Commission Findings

After careful review of the proposal, the Commission finds that the proposed rule changes are consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange. In particular, the Commission finds that the proposed rule change, subject to its term as a pilot, is consistent with Section 6(b)(5) of the Act,[29] 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 investors and the public interest; and not be designed to permit unfair discrimination between customers, issuers, brokers or dealers.

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27   See Notice, supra note 3, 78 FR at 68121 (explaining this distinction from the NYSE RLP and referencing the similarity with BYX); see also Nasdaq RPI Approval Order, supra note 24, 78 FR at 12398 (explaining that NASDAQ's program would execute potentially at multiple price levels, unlike the NYSE RLP).

28   See Notice, supra note 3, 78 FR at 68121 (discussing the three key distinctions in greater detail). See also supra note 12 and accompanying text (noting that RPI Orders also designated as MPL Orders would re-price as the PBBO changes).

29   15 U.S.C. 78f(b)(5).

The Commission finds that the Program, as it is proposed on a pilot basis, is consistent with the requirements of the Act because the Program is reasonably designed to benefit retail investors by providing price improvement to retail order flow.[30] The Commission also believes that the Program could promote competition for retail order flow among execution venues and that this could benefit retail investors by creating additional price improvement opportunities for their order flow.

Currently, most marketable retail order flow is executed in the OTC markets, pursuant to bilateral agreements, without ever reaching a public exchange. The Commission recently noted that "a very large percentage of marketable (immediately executable) order flow of individual investors" is executed, or "internalized," by broker-dealers in the OTC markets.[31] A recent review of the order flow of eight retail brokers revealed that nearly 100% of their customer market orders were routed to OTC market makers.[32] The same review found that such routing is often done pursuant to arrangements under which retail brokers route their order flow to certain OTC market makers in exchange for payment.[33]

To the extent that the Program may provide price improvement to retail orders that equals what would be provided under OTC internalization arrangements, the Program could benefit retail investors. To better understand the Program's potential impact, data concerning investor benefits, including the level of price improvement provided by the Program, will be submitted by

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[30]   As discussed above, supra notes 22 to 28 and accompanying text, the Commission recently approved similar programs for NYSE, NYSE MKT, BATS-Y Exchange, and The NASDAQ Stock Market.

[31]   See Securities Exchange Act Release No. 61358 (Jan. 14, 2010), 75 FR 3594, 3600 (Jan. 21, 2010) ("Concept Release on Equity Market Structure").

[32]   See id.

[33]   See id.

the Exchange[34] and would be reviewed by the Commission prior to any extension of the Program

beyond the proposed one-year pilot term, or any permanent approval of the Program.

The Program proposes to create additional price improvement opportunities for retail

investors by segmenting order flow on the Exchange and requiring liquidity providers that want

to interact with such retail order flow to do so at a price at least $0.001 per share better than the

PBBO. The Commission finds that, while the Program would treat retail order flow differently

from order flow submitted by other market participants, such segmentation would not be

inconsistent with Section 6(b)(5) of the Act, which requires that the rules of an exchange are not

designed to permit unfair discrimination. The Commission previously has recognized that the

markets generally distinguish between individual retail investors, whose orders are considered

desirable by liquidity providers because such investors are presumed on average to be less

informed about short-term price movements, and professional traders, whose orders are

presumed on average to be more informed.[35] The Commission has further recognized that,

because of this distinction, liquidity providers are generally more inclined to offer price

improvement to less-informed retail orders than to more-informed professional orders.[36]

Absent opportunities for price improvement, retail investors may encounter wider spreads

that are a consequence of liquidity providers interacting with informed order flow. By creating

additional competition for retail order flow, the Program is reasonably designed to attract retail

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[34]   The Exchange committed in the proposal to "produce data throughout the pilot, which would include statistics about participation, the frequency and level of price improvement provided by the Program, and any effects on the broader market structure." See Notice, supra note 3, 78 FR at 68120.

[35]   See, e.g., Nasdaq RPI Approval Order, supra note 24; BATS RPI Approval Order, supra note 23; and NYSE RLP Approval Order, supra note 22.

[36]   See, e.g., id.

order flow to the exchange environment, while helping to ensure that retail investors benefit from the better price that liquidity providers are willing to give their orders.

The Commission notes that the Program might also create a desirable opportunity for institutional investors to interact with retail order flow that they are not able to reach currently. ETP Holders that are not RLPs can seek to interact with Retail Orders by submitting RPI Orders. Today, institutional investors often do not have the chance to interact with marketable retail orders that are executed pursuant to internalization arrangements. Thus, by submitting RPI Orders, institutional investors may be able to reduce their possible adverse selection costs by interacting with retail order flow.

When the Commission is engaged in rulemaking or the review of a rule filed by a self-regulatory organization and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[37] As discussed above, the Commission believes this Program will promote competition for retail order flow by allowing ETP Holders, either as RLPs, or on an ad hoc basis, to submit RPI Orders to interact with Retail Orders. Such competition may promote efficiency by facilitating the price discovery process. Moreover, the Commission does not believe that the Program will have a significant effect on, or create any new inefficiencies in, current market structure. Finally, to the extent the Program is successful in attracting retail order flow, it may generate additional investor interest in trading securities, which may promote capital formation.

The Commission also believes that the Program is sufficiently tailored to provide the benefits of potential price improvement only to bona fide retail order flow originating from

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[37]   See 15 U.S.C. 78c(f).

natural persons.[38] The Commission finds that the Program provides an objective process by

which an ETP Holder could become an RMO and that it provides for appropriate oversight by

the Exchange to monitor for continued compliance with the terms of these provisions. The

Exchange has limited the definition of Retail Order to an agency or riskless principal order that

originates from a natural person and not from a trading algorithm or any other computerized

methodology. Furthermore, a Retail Order must be submitted by an RMO that is approved by

the Exchange. In addition, RMOs would be required to maintain written policies and procedures

to help ensure that they designate as Retail Orders only those orders that qualify under the

Program. If an ETP Holder's application to become an RMO is denied by the Exchange, that

member may appeal the determination or re-apply. The Commission believes that these

standards should help ensure that order flow submitted into the Program is retail order flow,

thereby promoting just and equitable principles of trade and protecting investors and the public

interest, while also providing an objective process through which ETP Holders may become

RMOs.

In addition, the Commission finds that the Program's proposed dissemination of a Retail

Liquidity Identifier would increase the amount of pricing information available to the

marketplace and is consistent with the Act. The identifier would be disseminated through the

consolidated public market data stream to advertise the presence of an RPI Order with which

Retail Orders could interact. The identifier would reflect the symbol for a particular security and

the side of the RPI Order interest, but it would not include the price or size of such interest. The

identifier would alert market participants to the existence of an RPI Order priced better than the

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[38]   In addition, the Commission believes that the Program's provisions concerning the
        approval and potential disqualification of RMOs are not inconsistent with the Act. See,
        e.g., NYSE RLP Approval Order, supra note 22, 77 FR at 40680 & n.77.

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PBBO and should provide market participants with more information about the availability of

price improvement opportunities for retail orders than is currently available.[39]

The Exchange stated that the proposed Program, which will operate similar to the retail

programs in place at the NYSE, NYSE MKT, BYX, and NASDAQ, should encourage additional

liquidity and competition among exchange venues, while providing the potential for price

improvement to retail investors.[40] The Exchange also noted that the Program would differ from

the existing NYSE RLP in that it would provide the maximum price improvement available to

incoming Retail Orders by allowing them to interact with available contra-side RPI Orders and

other price-improving, contra-side interest. Moreover, the Exchange's Program would allow

Retail Orders to execute at multiple price levels, as opposed to a single clearing price level. The

Commission finds that the Program is reasonably designed to enhance competition among

market participants and encourage competition among exchange venues. The Commission finds

further that the distinctions between the Exchange's Program and the other approved retail

programs are reasonably designed to enhance the Program's price-improvement benefits to retail

investors and, therefore, are consistent with the Act.

The Commission notes that it is approving the Program on a pilot basis. Approving the

Program on a pilot basis will allow the Exchange and market participants to gain valuable

practical experience with the Program during the pilot period. This experience should allow the

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[39]   As the Commission noted when approving the comparable retail programs of other
        exchanges, the Commission believes that the Program will not create any best execution
        challenges for brokers that are not already present in today's markets. A broker's best
        execution obligations are determined by a number of facts and circumstances, including:
        (1) the character of the market for the security (e.g., price, volatility, relative liquidity,
        and pressure on available communications); (2) the size and type of transaction; (3) the
        number of markets checked; (4) accessibility of the quotation; and (5) the terms and
        conditions of the order which result in the transaction. See, e.g., NYSE RLP Approval
        Order, supra note 22, 77 FR at 40680 n.75 (citing FINRA Rule 5310).

[40]   See notice, supra note 3, 78 FR at 68122.

Exchange and the Commission to determine whether modifications to the Program are necessary or appropriate prior to any Commission decision to approve the Program on a permanent basis. The Exchange also has agreed to provide the Commission with a significant amount of data that should assist the Commission in its evaluation of the Program. Specifically, the Exchange has represented that it "will produce data throughout the pilot, which will include statistics about participation, the frequency and level of price improvement provided by the Program, and any effects on the broader market structure."[41] The Commission expects that the Exchange will monitor the scope and operation of the Program and study the data produced during that time with respect to such issues and that the Exchange will propose any modifications to the Program that may be necessary or appropriate.

The Commission also welcomes comments, and empirical evidence, on the Program during the pilot period to further assist the Commission in its evaluation of the Program. The Commission notes that any permanent approval of the Program would require a proposed rule change by the Exchange, and that the filing of a proposed rule change would provide an opportunity for public comment prior to further Commission action

V.   Exemption from the Sub-Penny Rule

Pursuant to its authority under Rule 612(c) of Regulation NMS,[42] the Commission hereby grants the Exchange a limited exemption from the Sub-Penny Rule to operate the Program. For the reasons discussed below, the Commission determines that such action is necessary or appropriate in the public interest and that it is consistent with the protection of investors. The exemption shall operate for a period of 12 months, beginning with the effectiveness of the proposed rule change approved today.

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[41]   See supra note 34.

[42]   17 CFR 242.612(c).

When the Commission adopted the Sub-Penny Rule in 2005, it identified a variety of problems caused by sub-penny prices that the Sub-Penny Rule was designed to address:

- If investors' limit orders lose execution priority for a nominal amount, investors may over time decline to use them, thus depriving the markets of liquidity.

- When market participants can gain execution priority for a nominal amount, important customer protection rules such as exchange priority rules and the Manning Rule could be undermined.

- Flickering quotations that can result from widespread sub-penny pricing could make it more difficult for broker-dealers to satisfy their best execution obligations and other regulatory responsibilities.

- Widespread sub-penny quoting could decrease market depth and lead to higher transaction costs.

- Decreasing depth at the inside could cause institutions to rely more on execution alternatives away from the exchanges, potentially increasing fragmentation in the securities markets.[43]

At the same time, the Commission "acknowledge[d] the possibility that the balance of costs and benefits could shift in a limited number of cases or as the markets continue to evolve."[44] Therefore, the Commission also adopted Rule 612(c), which provides that the Commission may grant exemptions from the Sub-Penny Rule, either unconditionally or on specified terms and conditions, if it determined that such an exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

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[43]   See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37551-52 (June 29, 2005).

[44]   Id. at 37553.

The Commission believes that the Exchange's proposal is such a case. As described above, under the current market structure, few marketable retail orders in equity securities are routed to exchanges. The vast majority of marketable retail orders are internalized by OTC market makers, who typically pay retail brokers for their order flow. Retail investors can benefit from such arrangements to the extent that OTC market makers offer them price improvement over the NBBO. Price improvement is typically offered in sub-penny amounts.[45] An internalizing broker-dealer can offer sub-penny executions, provided that such executions do not result from impermissible sub-penny orders or quotations. Accordingly, OTC market makers typically select a sub-penny price for a trade without quoting at that exact amount or accepting orders from retail customers seeking that exact price. Exchanges – and exchange member firms that submit orders and quotations to exchanges – cannot compete for marketable retail order flow on the same basis, because it would be impractical for exchange electronic systems to generate sub-penny executions without exchange liquidity providers or retail brokerage firms having first submitted sub-penny orders or quotations, which the Sub-Penny Rule expressly prohibits.

The limited exemption granted today should promote competition between exchanges and OTC market makers in a manner that is reasonably designed to minimize the problems that the Commission identified when adopting the Sub-Penny Rule. Under the Program, sub-penny prices will not be disseminated through the consolidated quotation data stream, which should avoid quote flickering and associated reduced depth at the inside quotation. Furthermore, while the Commission remains concerned about providing enough incentives for market participants to

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[45]   When adopting the Sub-Penny Rule, the Commission considered certain comments that asked the Commission to prohibit broker-dealers from offering sub-penny price improvement to their customers, but declined to do so. The Commission stated that "trading in sub-penny increments does not raise the same concerns as sub-penny quoting" and that "sub-penny executions due to price improvement are generally beneficial to retail investors." Id. at 37556.

display limit orders, the Commission does not believe that granting this exemption (and approving the accompanying proposed rule change) will reduce such incentives. Market participants that display limit orders currently are not able to interact with marketable retail order flow because it is almost entirely routed to internalizing OTC market makers that offer sub-penny executions. Consequently, enabling the Exchange to compete for this retail order flow through the Program should not materially detract from the current incentives to display limit orders, while potentially resulting in greater order interaction and price improvement for marketable retail orders. To the extent that the Program may raise Manning and best execution issues for broker-dealers, these issues are already presented by the existing practices of OTC market makers.

The exemption being granted today is limited to a one-year pilot. The Exchange has stated that "sub-penny trading and pricing could potentially result in undesirable market behavior," and, therefore, it will "monitor the Program in an effort to identify and address any such behavior."[46] Furthermore, the Exchange has represented that it "will produce data throughout the pilot, which will include statistics about participation, the frequency and level of price improvement provided by the Program, and any effects on the broader market structure."[47] The Commission expects to review the data and observations of the Exchange before determining whether and, if so, how to extend the exemption from the Sub-Penny Rule.[48]

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[46]   See Request for Sub-Penny Rule Exemption, supra note 5, at 3, n.5.

[47]   See supra note 34 and accompanying text.

[48]   In particular, the Commission expects the Exchange to observe how maker/taker transaction charges, whether imposed by the Exchange or by other markets, might impact the use of the Program. Market distortions could arise where the size of a transaction rebate, whether for providing or taking liquidity, is greater than the size of the minimum increment permitted by the Program ($0.001 per share).

VI.   Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[49] that the

proposed rule change (SR-NYSEArca-2013-107) be, and hereby is, approved on a one-year pilot

basis.

IT IS ALSO HEREBY ORDERED that, pursuant to Rule 612(c) of Regulation NMS, the

Exchange is given a limited exemption from Rule 612 of Regulation NMS to allow it to accept

and rank orders priced equal to or greater than $1.00 per share in increments of $0.001, in the

manner described in the proposed rule changes above, on a one-year pilot basis beginning with

the effectiveness of the proposed rule change.

For the Commission, by the Division of Trading and Markets, pursuant to delegated

authority.[50]

> Kevin O'Neill
> Deputy Secretary

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[49]   15 U.S.C. 78s(b)(2).

[50]   17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(83).