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SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-73333; File Nos. SR-NYSE-2014-32 and SR-NYSEMKT-2014-56)

October 9, 2014.

Self-Regulatory Organizations; New York Stock Exchange LLC; NYSE MKT, Inc.; Order Approving Proposed Rule Changes Amending Exchange Rule 13 to Make the Add Liquidity Only Modifier Available for Limit Orders, and Make the Day Time-In-Force Condition and Add Liquidity Only Modifier Available for Intermarket Sweep Orders

I. Introduction

On June 27, 2014, New York Stock Exchange LLC (“NYSE”) and NYSE MKT LLC (“NYSE MKT”) (each an “Exchange” and together 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”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its Rule 13 to allow an Add Liquidity Only (“ALO”) modifier for day limit orders and to allow the day time-in-force condition and ALO modifier for Intermarket Sweep Orders (“ISO”).³ The proposed rule changes were published for comment in the Federal Register on July 11, 2014.⁴ On August 21, 2014, the Commission extended the time period in which to approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule changes to October 9, 2014.⁵ The Commission received three comment letters from two

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ NYSE MKT designates its Rule 13 as “Rule 13 – Equities.” All references to NYSE MKT rules in this order are to its equities rules, whether or not the “– Equities” designation is included in the reference.

⁴ See Securities Exchange Act Release Nos. 72548 (July 7, 2014), 79 FR 40183 (“NYSE Notice”) and 72547 (July 7, 2014), 79 FR 40169 (“NYSE MKT Notice”).

⁵ See Securities Exchange Act Release Nos. 72893 (Aug. 21, 2014), 79 FR 51208 (Aug. 27, 2014) and 72894 (Aug. 21, 2014), 79 FR 51208.

commenters on the NYSE Notice.⁶ On September 30 and October 8, 2014, NYSE submitted letters responding to the comment letters.⁷ This order approves the proposed rule changes.

II. Description of the Proposals

A. ALO Modifier for Day Limit Orders

Currently, only mid-point passive liquidity (“MPL”) orders are available with the ALO modifier on the Exchanges.⁸ The Exchanges propose to allow the use of the ALO modifier for day limit orders.⁹ As proposed, a limit order on either Exchange designated with the ALO modifier would not route and would not remove liquidity from the Exchange’s book. Limit

⁶ See Letter from Haim Bodek, Managing Principal, Decimus Capital Markets, LLC, to Commission, dated September 15, 2014 (“DCM Letter”); and Letters from Richard A. Tierney III, President and Chief Executive Officer, Bloomberg Tradebook LLC, and Gary Stone, Chief Strategy Officer, Bloomberg Tradebook LLC, to Brent J. Fields, Secretary, Commission, dated September 22, 2014 (“Tradebook Letter I”) and October 6, 2014 (“Tradebook Letter II”). The Commission notes that these comment letters address the NYSE proposal only. However, since the NYSE and NYSE MKT proposals are nearly identical, the Commission will treat the comment letters as addressing both the NYSE and the NYSE MKT proposals.

⁷ See Letter from Martha Redding, Chief Counsel, New York Stock Exchange, to Kevin M. O’Neill, Deputy Secretary, Commission, dated September 30, 2014 (“Response Letter I”); and Letter from Martha Redding, Chief Counsel, New York Stock Exchange, to Kevin M. O’Neill, Deputy Secretary, Commission, dated October 8, 2014 (“Response Letter II”). NYSE noted that the Response Letters were submitted in support of both the NYSE and NYSE MKT proposals.

⁸ See NYSE Rule 13 and NYSE MKT Rule 13 – Equities for the definition of MPL orders. MPL orders are currently available with the ALO modifier.

⁹ The following interest would not be eligible for the ALO modifier: (1) DMM interest entered via the Capital Commitment Schedule; (2) d-Quotes; (3) Sell “Plus – Buy “Minus” Orders; (4) Non-Display Reserve Orders or Non-Display Reserve e-Quotes; (5) Retail Orders or Retail Price Improvement Orders; or (6) High-priced securities. These terms and order types are defined in NYSE Rule 1000(a)(vi) and NYSE MKT Rule 1000(a)(vi) – Equities.

orders designated with an ALO modifier would be able to participate in the open or close, but the ALO modifier would be disregarded. A limit order with an ALO modifier would be required to represent at least one displayable round lot.

If, at the time of entry, a limit order with the ALO modifier were marketable against Exchange interest or would lock or cross a protected quotation in violation of Rule 610(d) of Regulation NMS (“Rule 610(d)”)¹⁰ the Exchange receiving the order would re-price and display the order at one minimum price variation (“MPV”) below the “best-priced sell interest” (for bids) or above the “best-priced buy interest” (for offers). The term “best-priced sell interest” refers to the lowest-priced sell interest against which incoming buy interest would be required to execute with or route to, including the receiving Exchange’s displayed offers, Non-Display Reserve Orders,¹¹ Non-Display Reserve e-Quotes,¹² and odd-lot sized sell interest, as well as protected offers on away markets, but not including non-displayed sell interest that is priced based on the protected best bid or offer (“PBBO”). The term “best-priced buy interest” refers to the highest-priced buy interest against which incoming sell interest would be required to execute with or route to, including the receiving Exchange’s displayed bids, Non-Displayed Reserve Orders, Non-Display Reserve e-Quotes, and odd-lot sized buy interest, as well as protected bids on away markets, but not including non-displayed buy interest that is priced based on the PBBO.

¹⁰ See 17 CFR 242.610(d).

¹¹ A “Non Displayed Reserve Order” is a limit order that is not displayed, but remains available for potential execution against all incoming automatically executing orders until executed in full or cancelled. See NYSE Rule 13 and NYSE MKT Rule 13 – Equities.

¹² See NYSE Rule 70(f)(II) and NYSE MKT Rule 70(f)(II) – Equities.

If, while an ALO limit order to buy is pending, the best-priced sell interest is re-priced higher, the ALO limit order would be re-priced and re-displayed one MPV below the new best-priced sell interest, up to the limit price of the ALO order. If, while an ALO limit order to sell is pending, the best-priced buy interest is re-priced lower, the ALO limit order would be re-priced and re-displayed one MPV above the new best-priced buy interest, down to the limit price of the ALO order. An ALO limit order would not be re-priced if it is displayed at its limit price or if the best-priced sell interest is re-priced lower (for bids) or if the best-priced buy interest is re-priced higher (for offers). Each time an ALO limit order is re-priced and re-displayed, that order would receive a new time stamp.

Limit orders designated with the ALO modifier would not be priced based on resting opposite-side MPL Orders, which are triggered to trade at the midpoint of the PBBO by arriving interest. Limit orders designated with the ALO modifier would not trigger opposite-side MPL Orders to trade.

Pegging interest to buy (sell) that is designated with the ALO modifier would not peg to a price that would result in execution before displaying and would instead peg one MPV below (above) the undisplayed Exchange sell (buy) interest against which it would have otherwise executed.

B. Day Time-in-Force Designation and ALO Modifier for ISOs

An ISO is currently defined in NYSE Rule 13 and NYSE MKT Rule 13 – Equities as a limit order designated for automatic execution that meets the following requirements: (i) it is identified as an ISO in the manner prescribed by the Exchange; and (ii) simultaneously with the routing of an ISO to the Exchange, one or more additional limit orders, as necessary, are routed

to execute against the full displayed size of any protected bid, in the case of a limit order to sell, or the full displayed size of any protected offer, in the case of a limit order to buy, and these additional orders are identified as ISOs. Currently, each Exchange immediately and automatically executes an ISO upon arrival, and the portion not so executed will be immediately and automatically cancelled.

Each Exchange proposes to define an ISO as a limit order designated for automatic execution in a particular security that is never routed to an away market, may trade through a protected bid or offer, and will not be rejected or cancelled if it would lock, cross, or be marketable against an away market, provided that it is identified as an ISO and that, simultaneously with the routing of the ISO to the Exchange, one or more additional limit orders, as necessary, are routed to execute against the full displayed size of any protected bid or offer.¹³

Each Exchange proposes to allow ISOs to operate with a day time-in-force condition (“Day ISO”). A Day ISO, if marketable upon arrival, would be immediately and automatically executed against the displayed bid (offer) up to its full size in accordance with and to the extent provided by each Exchange’s Rules 1000 to 1004, which address automatic executions of orders, and would then sweep the Display Book, as provided in each Exchange’s Rule 1000(d)(iii). The remaining unexecuted portion, if any, of a Day ISO would be posted to the Exchange’s book at its limit price and would be permitted to lock or cross a protected quotation that was displayed at the time of arrival of the Day ISO. A Day ISO would be required to represent a minimum of one

¹³ See NYSE Rule 19(d)(3) (permitting the display of a quotation that locks or crosses a protected quotation if the locking or crossing quotation was an automated quotation and if the member of the Exchange displaying the automated quotation simultaneously routed an intermarket sweep order to execute against the full displayed size of any locked or crossed protected quotation); NYSE MKT Rule 19(d)(3) – Equities (same).

displayable round lot. Day ISOs would be available for Minimum Display Reserve Orders and Minimum Display Reserve e-Quotes.

Each Exchange also proposes to allow a Day ISO to be designated with an ALO modifier. If, after being posted, a Day ISO would lock or cross a protected quotation in violation of Rule 610(d) of Regulation NMS, each Exchange would re-price and re-display the Day ISO consistent with the proposed ALO modifier for day limit orders. Any such re-pricing would be based on the best-priced sell interest (for bids) or best-priced buy interest (for offers), and a Day ISO would receive a new timestamp each time that it was re-priced.

A Day ISO designated with an ALO modifier that is marketable against Exchange interest upon arrival would be re-priced and displayed one MPV below the receiving Exchange's best-priced non-MPL Order sell interest (for bids) or above the Exchange's best-priced non-MPL Order buy interest (for offers). After being displayed on the Exchange's book, a Day ISO designated ALO would be re-priced and re-displayed consistent with the proposed ALO modifier.

Each Exchange proposes to specify that IOC ISOs and Day ISOs are not available for Sell "Plus" – Buy "Minus" Orders or Non-Display Reserve Orders or for Non-Display Reserve e-Quotes and that IOC ISOs are not available for high-priced securities, as defined in each Exchange's Rule 1000(a)(vi).¹⁴

¹⁴ Each Exchange also proposes to change certain references in its rules from "Intermarket Sweep Order" to "ISO." Each Exchange further proposes to define the existing form of an ISO as an "ISO designated IOC ('IOC ISO')."

III. Summary of Comments and the Exchanges' Response

As noted above, the Commission received three comment letters from two commenters on the proposed rule changes.¹⁵ The commenters generally raised three broad concerns regarding the proposals and urged the Commission to disapprove the filings.¹⁶

A. ALO Modifier Would Provide Queue Priority and Encourage Orders that Are Not Bona Fide

The first commenter expressed concern that the ALO modifier would provide queue priority over “traditional orders” because ALO orders, unlike “traditional orders,” would automatically re-price to a more aggressive price when permissible.¹⁷ The Exchanges responded that the ALO modifier would be available to all member organizations, including those that represent agency interest.¹⁸ The Exchanges also noted that a limit order designated ALO would receive a new time stamp each time it is re-priced and re-displayed, which the Exchanges believe

¹⁵ See note 6, supra.

¹⁶ Both commenters also raised broader issues, arguing that the increasing complexity of market structure, the proliferation of order types, and the alleged use by other exchanges of a Day ISO order type without Commission approval should be considered by the Commission in determining whether to approve or disapprove the Exchanges' filings. See DCM Letter at 7-8; Tradebook Letter at 8-9. The Commission notes that its obligation with respect to the Exchanges' proposals is to determine whether they are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.

¹⁷ See DCM Letter at 3-4. The commenter did not define “traditional orders.”

¹⁸ See Response Letter I at 4.

is consistent with current Exchange rules that provide that an order that is modified to change the price of the order shall receive a new time stamp.¹⁹

This commenter also stated its belief that the ALO modifier would encourage the submission of “overly aggressive” orders that are not bona fide, that “do not reflect the true economics of a security,” and whose primary function appears to “unfairly preference such orders for rebate capture at the most aggressive price possible.”²⁰ The Exchanges responded that aggressively priced orders “improve the public quote and provide better prices to contra-side interest” and stated that these are precisely the type of orders they are trying to promote.²¹ Additionally, Exchanges disagreed with the commenter’s belief that these types of orders are not bona fide because, according to the Exchanges, a member bears the risk of its order being re-priced to its limit price and being executed at that price.²²

B. The ALO Modifier Would Allow the Detection of Hidden Orders

The first commenter stated its belief that participants could use limit orders with the ALO modifier to detect hidden orders at the Exchanges by analyzing price-sliding confirmation messages. This commenter argued that, unlike comparable order types at other exchanges, an order with the ALO modifier is permitted to “forward-tick price-slide to establish prices when the hidden order on the contra-side is canceled, thereby leaking information about this hidden

¹⁹ See NYSE Notice, supra note 4, at 40185, and NYSE MKT Notice, supra note 4, at 40171. See also Response Letter I at 4-5 (providing examples of how re-pricing and the assignment of new time stamps would work and citing NYSE Rule 72(c)).

²⁰ See DCM Letter at 4.

²¹ See Response Letter I at 4.

²² Id.

order.”²³ The Exchanges responded that, because of the minimum display quantity requirement for limit orders with the ALO modifier and the related risk of a round-lot execution, it would be cost-prohibitive to use this functionality to probe for hidden interest.²⁴ The Exchanges further argued that the benefit associated with the proposed functionality (i.e., displayed liquidity at the Exchanges that is available to provide price improvement to incoming orders) outweighs the potential cost that a market participant could determine the existence, though not the depth, of hidden interest at a price.²⁵

C. The Day ISO and Day ISO ALO Order Types Are Inconsistent with Rule 610 of Regulation NMS

The first commenter expressed its belief that the proposed Day ISO ALO would encourage orders that lock or cross protected quotations, because the order type is designed to be accepted by the Exchanges at aggressive prices in conditions where high-frequency traders actually lock or cross away markets or appear to lock or cross away markets, thus defeating the intended purpose of ISOs to be “routed to execute” in such conditions.²⁶

The second commenter stated its belief that Day ISO and Day ISO ALO order types would violate Rule 610(d) of Regulation NMS.²⁷ This commenter argued that ensuring

²³ See DCM Letter at 4. The commenter also expressed its belief that the ALO modifier is inadequately disclosed to market participants. The Exchanges responded that the proposed rule text provided full disclosure.

²⁴ See Response Letter I at 5.

²⁵ See Response Letter I at 4.

²⁶ See DCM Letter at 5.

²⁷ See Tradebook Letter I at 4-5.

compliance with the prohibition against locking and crossing markets pursuant to Rule 610(d) is solely a self-regulatory organization (“SRO”) obligation,²⁸ and that only an SRO is allowed to “ship and post” (i.e., transmit an order to attempt to execute against a displayed quotation while posting a quotation that could lock or cross the displayed quotation).²⁹ This commenter further stated its belief that the Exchanges are improperly attempting to transfer to member firms the obligations of the Exchanges to reasonably avoid locking and crossing quotations, arguing that the receipt of an ISO does not absolve the Exchanges from the responsibility of checking the market before posting any remaining portion of that ISO.³⁰ And this commenter asserted that the Exchanges’ treatment of reserve interest creates a “systemic violation of Rule 610,” arguing that the proposed Day ISOs would not actually clear certain protected quotes because they would not interact with reserve interest behind the displayed portion of the protected quote.³¹

²⁸ See Tradebook Letter I at 5. This commenter argued that Regulation NMS prohibits an SRO from considering as cleared a protected quote in existence at the time a Day ISO arrives at the SRO. See *id.*

²⁹ See Tradebook Letter II at 6. The commenter believes that this interpretation is consistent with the Regulation NMS guidance on Rules 610 and 611 set forth in Question 5.02 in Responses to Frequently Asked Questions Concerning Rule 611 and 610 of Regulation NMS (“NMS Guidance”), available at <http://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm#sec5>.

³⁰ See Tradebook Letter II at 6. The commenter further stated its belief that the Commission should evaluate the proposal based on whether it is consistent with the requirements of the Act, and not rely on the Exchange’s response that the Exchanges would be at a competitive disadvantage vis-à-vis other exchanges. See Tradebook Letter II at 3.

³¹ See Tradebook Letter I at 6-8. This commenter asserts that certain exchanges update displayed interest with remaining reserve interest on an “instantaneous” basis and that, therefore, the Exchanges should not be able to post a Day ISO order that would lock or cross a replenished protected quote.

The Exchanges responded that the proposed order functionalities are consistent with approved rules on other exchanges, as well as Rule 610(d) and the NMS Guidance issued by the Commission’s Division of Trading and Markets.³² The Exchanges argued that there is not an absolute prohibition on exchanges displaying locking or crossing quotations, provided that the resulting locked or crossed market is consistent with an approved exception to Rule 610(d).³³ The Exchanges stated that their Rule 19 has long included several exceptions permitting locking or crossing quotations, such as the ISO exception, and the receipt of an ISO signals that such an order qualifies for an exception, consistent with Rule 610(d).³⁴ The Exchanges stated that inherent in the ISO exception to their respective rules against locking and crossing quotations is that an ISO would be displayed, and thus could lock or cross a protected quotation.³⁵

The Exchanges also responded that the NMS Guidance does not support the second commenter’s argument that the reference to “market participants” in the response to Question 5.02 of the NMS Guidance (ISO Exception to SRO Lock/Cross Rules) refers only to SROs and that, therefore, only SROs have the ability to “ship and post.”³⁶ The Exchanges further argued that such an interpretation would not only call into question the current use of ISOs by broker-

³² See Response Letter I at 6; see also NMS Guidance, supra note 29.

³³ See Response Letter I at 7; Response Letter II at 3.

³⁴ See Response Letter I at 7. The Commission notes that NYSE MKT Rule 19 – Equities contains the same provisions as NYSE Rule 19.

³⁵ See Response Letter I at 7; Response Letter II at 3.

³⁶ See Response Letter II at 3.

dealers,³⁷ but would be inconsistent with the Commission’s past approval of a rule filing by another exchange.³⁸ With respect to the reserve portion of protected quotes, the Exchanges argued that the unexecuted portion of a Day ISO would be posted on the Exchanges’ books “at its limit price and would lock or cross a protected quotation that was displayed at the time of the arrival of the Day ISO.”³⁹

IV. Discussion and Commission Findings

After carefully considering the proposals, the comments submitted, and the Exchanges’ responses to the comments, the Commission finds that the proposed rule changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁴⁰ In particular, the Commission finds that the proposals are consistent with Section 6(b)(5) of the Act,⁴¹ which requires, among other things, that the Exchanges’ rules be designed 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.

³⁷ Id.

³⁸ The Exchanges cite the Commission’s approval of an NYSE Arca rule filing that provides for the display of the remaining balance of an ISO that is not marked “immediate or cancel.” See Response Letter I at 6 (citing Securities Exchange Act Release No. 54549 (Sept. 29, 2006), 71 FR 59179 (Oct. 6, 2006) (SR-NYSEArca-2006-49)).

³⁹ See Response Letter I at 7-8 (emphasis in original).

⁴⁰ In approving the proposals, the Commission has considered the proposed rules’ impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁴¹ 15 U.S.C. 78f(b)(5).

The Commission does not believe that the ALO modifier for limit orders would provide unjustified queue priority or that it would encourage the submission of orders that are not bona fide. Limit orders with the ALO modifier will be fully executable at the prices at which they are priced and re-priced and are therefore bona fide orders. In addition, limit orders with the ALO modifier will receive queue priority only at the prices for which they are fully executable, which is a justifiable means of assigning queue priority that is commonly used by exchanges. Moreover, the Commission notes that the Exchanges would assign a new time stamp (and thus new time priority) on such orders whenever they are re-priced and re-displayed, which would prevent these orders from stepping in front of orders that are already on the Exchanges' order books, and that the ALO order modifier would be available for day limit orders submitted by any exchange member. The ALO modifier for day limit orders is designed to be used to provide liquidity on the Exchanges at aggressive prices, rather than to remove liquidity, and the Commission notes that the proposals would require that limit orders with the ALO modifier represent at least one round lot, which should promote orders that are not of insignificant odd-lot size. Thus, the Commission believes that these proposals have the potential to allow market participants to aggressively compete with each other to offer better prices to contra-side trading interest.

The Commission also believes that the requirement that an ALO limit order have a minimum size of one round lot should reduce the economic incentives for a submitting firm to attempt to use this order type to detect the presence of hidden interest on the Exchanges. The Commission also notes that, unlike hidden orders, the ALO limit order is designed to provide displayed liquidity to the market and thereby contribute to public price discovery – an objective

that is fully consistent with the Act.⁴² Accordingly, the Exchanges have determined to offer an order type that promotes displayed liquidity, while adding the minimum size requirement in an effort to minimize the potential for the order type to be used to detect the existence of undisplayed interest.

The Commission also finds that the proposed Day ISO and Day ISO ALO order types are consistent with Rule 610(d) of Regulation NMS. The NMS Guidance previously issued by Commission's Division of Trading and Markets clearly contemplates that not all ISOs would be immediate-or-cancel orders.⁴³ The NMS Guidance provides that, if a trading center chooses not to cancel the portion of ISOs that cannot be executed immediately, "its rules will need to address appropriately the subsequent handling of the unexecuted portions."⁴⁴ More generally, Rule 610 of Regulation NMS requires, among other things, that each SRO adopt, maintain, and enforce written rules that prohibit its members from engaging in a pattern or practice of displaying quotations that lock or cross protected quotations.⁴⁵

The Exchanges have adopted rules pursuant to Rule 610, and their rules include an ISO exception.⁴⁶ Under the ISO exception, market participants are permitted to "ship and post." The

⁴² See, e.g., Section 11A(a)(1)(C)(iii) and (iv) of the Exchange Act (objectives for the national market system include assuring the availability of information with respect to quotations in securities and the practicability of brokers executing investors' orders in the best market).

⁴³ See NMS Guidance, supra note 29 (Response to Question 3.01, "Handling Unexecuted Portions of ISOs").

⁴⁴ Id.

⁴⁵ See 17 CFR 242.610(d).

⁴⁶ See NYSE Rule 19; NYSE MKT Rule 19 – Equities.

exchanges have not proposed to amend this exception. Under the Exchanges' proposed amendments to their rules, the Day ISO subjected to an Exchange would be immediately executed against the Exchange's displayed quote, and then the remainder, if any, would be posted to the book, where it may lock or cross a protected quotation that is displayed at the time the Day ISO arrives. Under the "ship and post" exception, the market participants submitting the Day ISO would have to send one or more additional ISOs to execute against the protected quotations on other exchanges that would be locked or crossed, and thus, the Day ISO is consistent with Rule 610 of Regulation NMS. The Day ISO with the ALO modifier would function in a similar manner as the day limit order with the ALO modifier and the Day ISO, including re-pricing and re-displaying.

For the reasons discussed above, the Commission finds that the Exchanges' proposals are consistent with the Act.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴⁷ that the proposed rule changes SR-NYSE-2014-32 and SR-NYSEMKT-2014-56, be and hereby are, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁸

Kevin M. O'Neill,
Deputy Secretary.

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⁴⁷ 15 U.S.C. 78s(b)(2).

⁴⁸ 17 CFR 200.30-3(a)(12).