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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-74440; File No. SR-NYSEMKT-2014-116)

Self-Regulatory Organizations; NYSE MKT LLC; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Amend Rule 967NY and to Adopt Rule 967.1NY to Provide Price Protection for Market Maker Quotes

March 4, 2015

I. Introduction

On December 29, 2014, NYSE MKT LLC (“Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Exchange Rule 967NY (Price Protection) and to adopt Exchange Rule 967.1NY to provide price protection for Market Maker quotes. The proposed rule change was published for comment in the Federal Register on January 14, 2015.<sup>3</sup> The Commission received no comment letters on the proposal. On March 2, 2015, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>4</sup> This order approves the proposed rule change, as modified by Amendment No. 1 thereto.

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<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. 74017 (January 8, 2015), 80 FR 1979 (“Notice”).

<sup>4</sup> In Amendment No. 1, the Exchange clarified that it believes that Market Maker bids should not be priced the same as or higher than the corresponding benchmark, which would be the price of the underlying security for call options and the strike price for put options. Amendment No. 1 does not change any of the proposed rule text that was submitted in the original filing. Amendment No. 1 is technical in nature and, therefore, the Commission is not publishing it for comment.

## II. Description of the Proposal

The Exchange proposed to amend Exchange Rule 967NY and to adopt Exchange Rule 967.1NY to provide price protection for Market Maker quotes. Exchange Rule 967NY currently applies and will continue to apply solely to orders. Exchange Rule 967NY(b), provides a price protection filter for incoming limit orders, pursuant to which the Exchange rejects limit orders priced a specified percentage<sup>5</sup> through the National Best Bid (“NBB”) or National Best Offer (“NBO”) (“Limit Order Filter”). To clarify that Exchange Rule 967NY applies only to orders, the Exchange proposed to append the word “Orders” to the Exchange Rule 967NY header to provide “Rule 967NY. Price Protection – Orders.”<sup>6</sup>

### A. Proposed Market Maker Quote Price Protection

The Exchange proposed to adopt new Exchange Rule 967.1NY to provide for a price protection mechanism for quotes entered by a Market Maker. Exchange Rule 967.1NY(a) will provide price protection filters applicable only for quotes entered by a Market Maker pursuant to Rule 925.1NY and will not be applicable to orders entered by a Market Maker. The Exchange proposed to provide for two layers of price protection that will be applicable to all incoming Market Maker quotes.<sup>7</sup> The first layer of price protection will assess incoming sell quotes

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<sup>5</sup> Pursuant to Exchange Rule 967NY(b), unless determined otherwise by the Exchange and announced to ATP Holders via Trader Update, the specified percentage is 100% for the contra-side NBB or NBO priced at or below \$1.00 and 50% for contra-side NBB or NBO priced above \$1.00. See Notice, supra note 3, at 1979.

<sup>6</sup> See Notice, supra note 3, at 1979.

<sup>7</sup> The Exchange states that the proposal will assist with the maintenance of fair and orderly markets by averting the risk of Market Maker quotes sweeping through multiple price points resulting in executions at prices that are through the last sale price or National Best Bid or Best Offer (“NBBO”). See Notice, supra note 3, at 1979.

against the NBB and incoming buy quotes against the NBO.<sup>8</sup> The second layer of price protection will assess the price of call or put bids against a specified benchmark.

1. NBBO Price Reasonability Check

Proposed Exchange Rule 967.1NY(a)(1) sets forth the Exchange's proposed NBBO price reasonability check, which will compare Market Maker bids with the NBO and Market Maker offers with the NBB. Specifically, provided that an NBBO is available, a Market Maker quote will be rejected if it is priced a specified dollar amount or percentage through the contra-side NBBO as follows:

- (A) \$1.00 for Market Maker bids when the contra-side NBO is priced at or below \$1.00;
- or
- (B) 50% for Market Maker bids (offers) when the contra-side NBO (NBB) is priced above \$1.00.

The Exchange will reject inbound Market Maker quotes that exceed the parameters set forth in proposed Exchange Rule 967.1NY(a)(1)(A)-(B).<sup>9</sup> The Exchange states that it has proposed a specific dollar threshold for when the NBO is priced at or below \$1.00 because, for such low-priced NBOs, the Exchange believes it is appropriate to provide Market Makers with the ability to enter quotes at least \$1.00 higher than the prevailing NBO.<sup>10</sup> For example, if the NBO were \$0.06, when using a 100% filter, the Exchange would be required to reject any bids priced \$0.12 or more. In addition, the Exchange proposed that pursuant to proposed Exchange

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<sup>8</sup> The Exchange represents that this proposed price protection mechanism is similar to the Exchange's Limit Order Filter. See Notice, supra note 3, at 1979.

<sup>9</sup> The Exchange states that the proposed percentages are appropriate because they are based on the percentages established for the Limit Order Filter. See Notice, supra note 3, at 1979.

<sup>10</sup> See Notice, supra note 3, at 1979.

Rule 967.1NY(a)(1)(A), Market Maker offers that arrive when the NBB is priced at or below \$1.00 will not be subject to this filter. The Exchange notes that when the NBB is priced at or below \$1.00, the price of an offer will be bound by \$0.00, and therefore an offer will always be less than \$1.00 away from the NBB.<sup>11</sup>

Because there may be market scenarios that require the proposed parameters to be adjusted, for example, during periods of extreme price volatility, the Exchange has further proposed that the Exchange may revise these parameters, provided such revised parameters are announced to ATP Holders via a Trader Update.<sup>12</sup>

The Exchange also proposed that if a Market Maker quote is rejected pursuant to paragraph (a)(1) of the proposed rule, the Exchange will also cancel any resting same-side quote in the affected series from that Market Maker.<sup>13</sup> According to the Exchange, even if the new quote is rejected because it is priced a specified dollar amount or percentage through the contra-side NBBO, in violation of proposed Exchange Rule 967.1NY(a)(1), the Market Maker's implicit instruction to cancel the resting quote remains valid nonetheless.<sup>14</sup>

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<sup>11</sup> The Exchange states that such offer prices would likely not be erroneous and therefore the Exchange does not believe it necessary to reject such Market Maker offers. See Notice, supra note 3, at 1980.

<sup>12</sup> See proposed Exchange Rule 967.1NY(a)(1)(A)-(B) (setting forth the specified dollar amount or percentages "unless determined otherwise by the Exchange and announced to ATP Holders via Trader Update").

<sup>13</sup> See proposed Exchange Rule 967.1NY(b). The Exchange states that it believes it is appropriate to reject any resting same-side quote because when a Market Maker submits a new quote, that Market Maker is implicitly instructing the Exchange to cancel any resting quote in that same series. See Notice, supra note 3, at 1980.

<sup>14</sup> See Notice, supra note 3, at 1980 for examples illustrating how proposed Exchange Rule 967.1NY(a) will operate.

## 2. Underlying Stock Price/Strike Price Check

The Exchange also has proposed new Exchange Rule 967.1NY(a)(2) and (3) which will set forth the Exchange's proposed second layer of price protection filters for Market Maker quotes. These price protection mechanisms will be applicable when either there is no NBBO available, for example, during pre-opening or prior to conducting a re-opening after a trading halt, or if the NBBO is so wide as to not to reflect an appropriate price for the respective options series. Proposed Exchange Rule 967.1NY(a)(2) will also provide price protection for Market Maker bids in call options. As proposed, if such bids equal or exceed the price of the underlying security, the Market Maker bid will be rejected.<sup>15</sup>

Under new Exchange Rule 967.1NY(a)(2)(A), before the underlying security is open, the Exchange will use the previous day's closing price to determine the price of the underlying security.<sup>16</sup> Under new Exchange Rule 967.1NY(a)(2)(B), once the underlying security has opened, the Exchange will use the consolidated last sale price to determine the price of the underlying security. Under new Exchange Rule 967.1NY(a)(2)(C), during a trading halt of the

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<sup>15</sup> See proposed Exchange Rule 967.1NY(a)(2). With a call bid, a Market Maker is bidding to buy an option that would be exercised into the right to acquire the underlying security. The Exchange states that it does not believe that a derivative product, which conveys the right to purchase a security underlying the derivative, should ever be priced the same as or higher than the prevailing price of the underlying security itself. Accordingly, the Exchange believes it is appropriate to reject Market Maker bids for call options that are equal to or in excess of the price of the underlying security. See Notice, supra note 3, at 1980. See also Amendment No. 1, supra note 4.

<sup>16</sup> According to the Exchange, although the underlying securities may trade in the equities markets outside of 9:30 a.m. ET to 4:00 p.m. ET, the equities market is generally not as liquid during this time and equity market makers generally do not have quoting obligations in after-hours trading. Therefore, the Exchange believes that using the previous day's closing price – based on trading during Core Trading Hours, when the market is most liquid – provides a more accurate benchmark and thus a more precise price protection filter for underlying securities that have not yet opened. See Notice, supra note 3, at 1980.

underlying security, the Exchange will use the consolidated last sale reported immediately prior to the trading halt to determine the price of the underlying security.<sup>17</sup> New Exchange Rule 967.1NY(a)(3) will provide for price protection for Market Maker bids in put options. In particular, any Market Maker bid for put options will be rejected if the price of the bid is equal to or greater than the strike price of the option.<sup>18</sup>

The Exchange also has proposed that when a Market Maker quote is rejected pursuant to paragraph (a)(2) or (a)(3) of the proposed rule, the Exchange will also cancel all resting quote(s) in the affected class(es) from that Market Maker and will not accept new quote(s) in the affected class(es) until the Market Maker submits a message (which may be automated) to the Exchange to enable the entry of new quotes.<sup>19</sup>

#### B. Implementation

The Exchange stated that it would announce the implementation date of the proposed rule change in a Trader Update and publish such announcement at least 30 days prior to implementation.

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<sup>17</sup> The Exchange believes that the consolidated last sale price for an underlying security that has already opened will provide the most accurate benchmark because the market is most liquid during Core Trading Hours. See Notice, supra note 3, at 1981.

<sup>18</sup> The Exchange states that the value of a put can never exceed the strike price of the option, even if the stock goes to zero. For example, a put with a strike price of \$50 gives the holder the right to sell the underlying security for \$50 (no more, or no less), therefore the Exchange states that it would be illogical to pay \$50 or more for the right to sell that underlying security, no matter what the price of the underlying security. See Notice, supra note 3, at 1981. See also Amendment No. 1, supra note 4.

<sup>19</sup> See proposed Exchange Rule 967.1NY(b). The Exchange believes that this temporary suspension from quoting in the affected option class(es) would operate as a safety valve that forces Market Makers to re-evaluate their positions before requesting to re-enter the market. See Notice, supra note 3, at 1981. See also Notice, supra note 3, at 1981 for examples illustrating how proposed Exchange Rule 967.1NY(a)(2) and (a)(3) would operate.

### 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>20</sup> In particular, the Commission finds that the proposed rule change is consistent with sections 6(b)(5) of the Act,<sup>21</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 investors and the public interest.

The proposed rule change provides a price protection mechanism for quotes entered by a Market Maker when an NBBO is available that are priced a specified dollar amount or percentage through the last sale or prevailing contra-side market, which the Exchange believes is evidence of error. The Commission believes that the proposed price protection mechanism is reasonably designed to promote just and equitable principles of trade by preventing potential price dislocation that could result from erroneous Market Maker quotes sweeping through multiple price points resulting in executions at prices that are through the last sale price or NBBO.<sup>22</sup>

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<sup>20</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>21</sup> 15 U.S.C. 78f(b)(5).

<sup>22</sup> See Notice, supra note 3, at 1981.

The Exchange's proposed use of benchmarks to check the reasonability of Market Maker bids for call and put options affords a second layer of price protection to Market Maker quotes. The Commission believes that the additional price reasonability check on Market Maker bids that are priced equal to or greater than the price of the underlying security for call options, and equal to or greater than the strike price for put options, is reasonably designed to operate in manner that would remove impediments to and perfect the mechanism of a free and open market and protect investors and the public interest. Further, the Commission notes the Exchange's belief that the additional risk controls that result in the cancellation of a Market Maker's resting same side quote and/or the temporary suspension a Market Maker's quoting activity in the affected option class(es), as applicable, provide market participants with additional protection from anomalous executions.<sup>23</sup>

Accordingly, the Commission believes that the proposed price protection for Market Maker quotes is reasonably 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.

#### IV. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.

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<sup>23</sup> See Notice, supra note 3, at 1982.



IT IS THEREFORE ORDERED, pursuant to section 19(b)(2) of the Act,<sup>24</sup> that the proposed rule change (SR-NYSEMKT-2014-116), as modified by Amendment No. 1, be, and hereby is, approved.

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

Jill M. Peterson,  
Assistant Secretary.  
[FR Doc. 2015-05496 Filed:  
3/9/2015 08:45 am; Publication  
Date: 3/10/2015]

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

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