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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-83768; File No. SR-NYSE-2018-26)

August 3, 2018

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Amending the Exchange's Rules Relating to Reserve Orders, Primary Pegged Orders, and Setter Priority for UTP Securities Trading on the Exchange's Pillar Platform

I. Introduction

On June 1, 2018, New York Stock Exchange LLC ("NYSE" 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 amend NYSE rules concerning Reserve Orders,³ Primary Pegged Orders,⁴ and setter priority.⁵ On June 8, 2018, the Exchange filed Amendment No. 1 to the proposed rule change, which replaced and superseded the proposed rule change in its entirety.⁶ The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on June 20, 2018.⁷ The Commission has received no comments on the proposed rule change. This order approves the proposed rule change, as modified by Amendment No. 1.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See NYSE Rule 7.31(d)(1).

⁴ See NYSE Rule 7.31(h)(2).

⁵ See NYSE Rule 7.36(h) for the rules concerning setter priority.

⁶ In Amendment No. 1, among other changes, the Exchange revised proposed Section 7.31(d)(1)(B) to clarify that the term "child" order refers to each display quantity with a different working time. Amendment No. 1 was reflected in the notice of filing of proposed rule change that was published in the Federal Register. See infra note 7.

⁷ See Securities Exchange Act Release No. 83432 (Jun. 14, 2018), 83 FR 28701 (Jun. 20, 2018) ("Notice").

II. Description of the Proposed Rule Change, as Modified by Amendment No. 1

The Exchange proposes several changes to the Reserve Order and the Primary Pegged Order, as set forth in NYSE Rule 7.31. The Exchange also proposes changes to the setter priority, as set forth in NYSE Rule 7.36(h).

A. Reserve Orders

The Exchange proposes several changes to the rules for Reserve Orders, in order to reduce the number of child orders associated with each Reserve Order, to codify existing functionality, and provide more clarity to existing Exchange rules. A “Reserve Order” is a limit order with a quantity displayed, ranked Priority 2 – Display Orders, and a non-displayed quantity held in reserve, ranked Priority 3 – Non-Displayed.⁸ Both the display quantity and the reserve interest of an arriving marketable Reserve Order are eligible to trade with resting interest in the Exchange Book or to route to an Away Market.⁹

First, the Exchange proposes to change how the displayed quantity is replenished. Currently, the display portion is replenished following any execution. Under the proposed rule change, the displayed portion of a Reserve Order would be replenished only when the display quantity has been decremented to below one round lot. The replenish quantity would be the minimum display size of the order or the remaining quantity of the reserve interest if it is less

⁸ See Section II.C. infra for a description of the Exchange’s setter priority.

⁹ See NYSE Rule 7.31(d)(1). The term “Exchange Book” is defined in NYSE Rule 1.1(a) as the Exchange’s electronic file of orders, containing all orders on the Exchange. The term “Away Market” is defined in NYSE Rule 1.1(ff) as any exchange, alternative trading systems or other broker-dealer with which the Exchange maintains an electronic linkage and that provides instantaneous responses to orders routed from the Exchange. The Exchange will designate from time to time those ATSS or other broker-dealers that qualify as Away Markets.

than the minimum display quantity.¹⁰ According to the Exchange, this proposed change would reduce the number of child orders.¹¹ The Exchange asserts that minimizing the number of child orders for a Reserve Order would reduce the potential for market participants to detect that a child order that appears on the Exchange's proprietary market data feeds is associated with a Reserve Order,¹² and the Exchange further notes that the proposed change would be consistent with the functioning of reserve orders on other national securities exchanges.¹³

Second, the Exchange proposes that when a Reserve Order is replenished from reserve interest and already has two child orders that, if combined, would equal less than one round lot, the child order with the later working time would rejoin the reserve interest and be assigned the new working time assigned to the next replenished quantity.¹⁴ According to the Exchange, the proposed addition would reduce the potential for market participants to detect that a child order is associated with a Reserve Order.¹⁵

Third, the Exchange proposes to amend its rules to reflect that, if a Reserve Order is not routable, the replenish quantity will be assigned a display and working price consistent with the

¹⁰ See Proposed NYSE Rule 7.31(d)(1)(A). This language replaces the current text that states “[t]he Exchange will display the full size of the Reserve Order when the unfilled quantity is less than the minimum display size for the order,” which the Exchange proposes to delete.

¹¹ See Notice, supra note 7, at 28702. The Exchange proposes to define the term “child order” in proposed NYSE Rule 7.31(d)(1)(B). A “child” order would be each display quantity of a Reserve Order with a different working time.

¹² See Notice, supra note 7, at 28702.

¹³ See Notice, supra note 7, at 28704.

¹⁴ See Proposed NYSE Rule 7.31(d)(1)(B)(i). The Exchange proposes to amend NYSE Rule 7.36(h)(3)(C) to treat child orders that fall under this provision consistent with the current NYSE rules which provide that odd-lot orders that are assigned new working times lose Setter Priority. See Proposed NYSE Rule 7.36(h)(3)(C).

¹⁵ See Notice, supra note 7, at 28704.

instructions of the order.¹⁶ The Exchange asserts that the proposed rule text represents current functionality and would add transparency and clarity to the Exchange's rules.¹⁷

Fourth, the Exchange proposes new rules concerning routable Reserve Orders. Under the proposed rules, the Exchange would evaluate a routable Reserve Order for routing both on arrival and each time the displayed quantity is replenished.¹⁸ In cases where an order is required to be routed, the Exchange proposes that the routing quantity would route from the reserve interest before the display quantity is published.¹⁹ Further, if after routing from the reserve interest, less than one round lot remains that is available to display, the Exchange proposes to wait until the routed quantity returns (executed or unexecuted) before publishing the display quantity.²⁰ According to the Exchange, this functionality would reduce the possibility of having multiple child orders.²¹

Fifth, the Exchange proposes to amend its rules to reflect how it currently treats the quantity of a routed Reserve Order that is returned unexecuted.²² According to the Exchange, such interest joins the working time of the existing reserve interest.²³ If there is no reserve interest, the returned quantity is assigned a new working time as reserve interest.²⁴ The Exchange asserts that this treatment is appropriate because at the time the unexecuted routed interest

¹⁶ See Proposed NYSE Rule 7.31(d)(1)(B)(ii).

¹⁷ See Notice, supra note 7, at 28702.

¹⁸ See Proposed NYSE Rule 7.31(d)(1)(D).

¹⁹ See Proposed NYSE Rule 7.31(d)(1)(D)(i).

²⁰ Id.

²¹ See Notice, supra note 7, at 28702.

²² See Notice, supra note 7, at 28703.

²³ See Proposed NYSE Rule 7.31(d)(1)(D)(ii).

²⁴ Id.

returns to the Exchange, the order may not be eligible to replenish the display quantity.²⁵ In either case, the reserve interest would replenish the display quantity under the circumstances described above.²⁶

Finally, the Exchange proposes to add rule text specifying that requests to reduce the size of a Reserve Order will result in the cancellation of the reserve interest before the cancellation of the display quantity.²⁷ The Exchange also proposed that, if there is more than one child order, the child order with the later working time will be canceled first.²⁸

B. Primary Pegged Order

A “Primary Pegged Order” is a pegged order to buy (sell) with a working price that is pegged to the PBB (PBO),²⁹ with no offset allowed.³⁰ These orders are rejected on arrival, or canceled when resting, if there is no PBB (PBO) against which to peg. Current NYSE Rule 7.31(h)(2)(B) provides that a Primary Pegged Order will be rejected when the PBBO is locked or crossed. The Exchange proposes that, in addition, if the PBBO is locked or crossed when the display quantity of the Primary Pegged Reserve Order is to be replenished, the entire order will be canceled.³¹

²⁵ See Notice, supra note 7, at 28703.

²⁶ See Proposed NYSE Rule 7.31(d)(1)(D)(ii).

²⁷ See Proposed NYSE Rule 7.31(d)(1)(E).

²⁸ Id.

²⁹ The terms “PBB” and “PBO” are defined in NYSE Rule 1.1(dd) as highest protected bid or best protected bid and lowest protected offer or best protected offer, respectively.

³⁰ See NYSE Rule 7.31(h)(2).

³¹ See Proposed NYSE Rule 7.31(h)(2)(B).

C. Setter Priority

On the Exchange, setter priority means that the market participant that sets the best bid or offer on the Exchange while either establishing a new NBBO³² or joining an Away Market NBBO³³ receives priority in the allocation of executions over other interest at the same price level.³⁴ On the Exchange, only one order is eligible for setter priority at each price.³⁵ The market participant with the setter priority receives 15% of each trade at that price (after unexecuted market orders with the same working price have executed),³⁶ plus its parity share, until the setter's order is filled.³⁷

The Exchange proposes to amend the setter priority rule to reflect the existing operation of this function, under which an order is not eligible for setter priority if there is an odd-lot sized order with setter priority at that price.³⁸ The Exchange states that this change is consistent with current functionality and asserts that the change would add transparency and clarity to its rules.³⁹

³² See NYSE Rule 1.1(dd). The term "NBBO" means the national best bid or offer.

³³ See id. for definition of "NBBO." See NYSE Rule 1.1(ff) for a definition of "Away Market."

³⁴ See NYSE Rules 7.36(h) and 7.37(b).

³⁵ See NYSE Rules 7.36(h)

³⁶ See NYSE Rule 7.36(e) (stating that unexecuted market orders have first priority (Orders ranked Priority 1- Market Orders), non-marketable limit orders with a displayed working price have second priority (Orders ranked Priority 2 – Display Orders), and non-marketable limit orders with no displayed working price have third priority (Orders ranked Priority 3 – Non-Display Orders). Setter priority would be assigned to an order with second priority (Priority 2 – Display Orders). See NYSE Rule 7.36(h).

³⁷ See NYSE Rule 7.37(b) for order allocation, including, but not limited to, the Exchange's allocation wheel, parity allocation, and Exchange book participant allocation, and floor broker participation.

³⁸ See Proposed NYSE Rule 7.36(h).

³⁹ See Notice, supra note 7, at 28703.

The Exchange proposes to add similar language to NYSE Rule 7.36(h)(1)(D) to specify that, during a Short Sale Period, if an odd-lot child of a short sale Reserve Order has setter priority, and the Permitted Price at which the order would be replenished would be a different price, the replenish quantity would not be eligible for setter priority.⁴⁰

The Exchange also proposes to add two circumstances in which an order would be evaluated for setter priority. Currently, an order will be evaluated for setter priority on arrival (including any portion that has been routed and returns unexecuted) and when the order becomes eligible to trade for the first time upon transitioning to a new trading session.⁴¹ First, NYSE proposes that an order would be evaluated for setter priority when resting and assigned a new display price.⁴² If multiple orders reprice at the same time, none of the orders would be eligible for setter priority unless one order is equal to or greater than a round lot and the sum of the other orders at the same price is less than one round lot.⁴³ Second, the Exchange proposes that an order would be evaluated for setter priority when the display quantity of a Reserve Order is replenished.⁴⁴ The Exchange asserts that, if a repriced resting or replenished Reserve Order meets the conditions for establishing setter priority,⁴⁵ then that order is aggressively displaying

⁴⁰ See Proposed NYSE Rule 7.36(h)(1)(D).

⁴¹ See NYSE Rule 7.36(h)(1)(A) - (B).

⁴² See Proposed NYSE Rule 7.36(h)(1)(C).

⁴³ Id.

⁴⁴ See Proposed NYSE Rule 7.36(h)(1)(D). In connection with this proposed change, the Exchange also proposed to delete current NYSE Rule 7.36(h)(4)(B), which states that setter priority is not available when the reserve quantity replenishes the display quantity of a Reserve Order.

⁴⁵ The requirements for an order to achieve setter priority are that it is an order ranked Priority 2 – Display Orders with a display quantity of at least one round lot, that it establishes a new BBO, and that it either establishes a new NBBO or joins an Away Market NBBO. See NYSE Rule 7.36(h).

liquidity on the Exchange, which the Exchange seeks to encourage by providing a setter priority allocation.⁴⁶

III. Discussion and Commission Findings

After careful review of the proposal, as modified by Amendment No. 1, the Commission finds that the proposed rule change is consistent with the requirements of the Act⁴⁷ and the rules and regulations thereunder applicable to a national securities exchange.⁴⁸ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁴⁹ which requires that the rules of an 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 proposal would alter how UTP Securities trade on the Exchange's Pillar trading platform with respect to two order types—reserve orders and primary pegged orders—and would also amend the rules that determine when orders are eligible for setter priority. The proposed changes relating to Reserve Orders would seek to reduce the quantity of child orders and the potential for information leakage. The Commission believes that the proposal to replenish the displayed quantity when it falls below one round lot is consistent with reserve order functioning on other national securities exchanges that the Commission has found to be consistent with the

⁴⁶ See Notice, supra note 7, at 28704-05.

⁴⁷ 15 U.S.C. 78f.

⁴⁸ 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).

⁴⁹ 15 U.S.C. 78f(b)(5).

Exchange Act.⁵⁰ The Commission also believes that the proposal is consistent with Section 6(b)(5)—with respect to replenishing a Reserve Order that has two existing child orders totaling less than one round lot, routing from reserve interest before publishing the display quantity, and aligning the Exchange’s rule text to the existing treatment of Reserve Orders that are not routable and of routed Reserve Orders that return unexecuted—because the proposed changes are reasonably designed to encourage the provision of liquidity on the exchange by reducing the likelihood of adverse selection against liquidity providers through information leakage and providing clarity to market participants, while not permitting unfair discrimination on the exchange.

The proposed changes relating to Primary Pegged Reserve Orders would provide that, if the PBBO is locked or crossed when the display quantity of the order is to be replenished, the entire order would be canceled. The Commission believes that the proposal is reasonably designed to prevent the display of locked or crossed quotations in NMS securities.

The rules relating to the setter priority would change in two ways. First, the rules would be amended to reflect that, under existing order function, an order is not eligible for setter priority if there is an odd-lot sized order with setter priority at that price. Second, orders would be evaluated for setter priority under two additional circumstances—when an order is resting and assigned a new display price, and when the display quantity of a Reserve Order is replenished. The Commission believes that these proposed changes are reasonably designed to provide incentives for market participants to display liquidity on the Exchange.

Accordingly, the Commission finds that the proposal is consistent with the requirements of the Act, and is designed to promote just and equitable principles of trade, to remove

⁵⁰ See Notice, supra note 7, at 28704.

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

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁵¹ that the proposed rule change (SR-NYSE-2018-26), 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.⁵²

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Assistant Secretary

⁵¹ 15 U.S.C. 78s(b)(2).

⁵² 17 CFR 200.30-3(a)(12).

