

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68305; File No. SR-NYSEMKT-2012-67)

November 28, 2012

Self-Regulatory Organizations; NYSE MKT LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Moving the Rule Text that Provides for Pegging on the Exchange from Supplementary Material .26 of Rule 70 –Equities to Rule 13- Equities and Amending Such Text to (i) Permit Designated Market Maker Interest To Be Set as Pegging Interest; (ii) Change References from National Best Bid, National Best Offer and National Best Bid or Offer to Best Protected Bid, Best Protected Offer and Best Protected Bid or Offer, Respectively; (iii) Permit Pegging Interest to Peg to the Opposite Side of the Market; and (iv) Provide for An Offset Value to be Specified for Pegging Interest

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 14, 2012, NYSE MKT LLC (the “Exchange” or “NYSE MKT”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange filed the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to move the rule text that provides for pegging on the Exchange from Supplementary Material .26 of Rule 70 - Equities to Rule 13 - Equities and amend such text to (i) permit Designated Market Maker (“DMM”) interest to be set as pegging interest; (ii) change references from national best bid (“NBB”), national best offer (“NBO”) and national best

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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> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

bid or offer (“NBBO”) to best protected bid (“PBB”), best protected offer (“PBO”) and best protected bid or offer (“PBBO”), respectively; (iii) permit pegging interest to peg to the opposite side of the market; and (iv) provide for an offset value to be specified for pegging interest. The text of the proposed rule change is available on the Exchange’s website at [www.nyse.com](http://www.nyse.com), at the principal office of the Exchange, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to move the rule text that provides for pegging on the Exchange from Rule 70.26 – Equities (“Rule 70.26”) (Pegging for d-Quotes and e-Quotes)<sup>5</sup> to Rule 13 – Equities (“Rule 13”) and amend such text to (i) permit DMM interest to be set as pegging interest; (ii) change references from NBB, NBO and NBBO to PBB, PBO and PBBO, respectively; (iii) permit pegging interest to peg to the opposite side of the market; and (iv) provide for an offset value to be specified for pegging interest. In moving this text to Rule 13, the Exchange proposes to make several other changes to the rule text, so that the proposed substantive changes described above can be incorporated in a logical and transparent manner and

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<sup>5</sup> E-Quotes are Floor broker agency interest files. D-Quotes are e-Quotes for which a Floor broker has entered discretionary instructions as to size and/or price.

to streamline the rule in a non-substantive manner.

### Background

The New York Stock Exchange LLC (“NYSE”) adopted NYSE Rule 70.26 as part of its Hybrid Market initiative to provide the ability for Floor brokers to add pegging instructions to e-Quotes.<sup>6</sup> Since its original adoption, the pegging functionality has been amended a number of times to, among other things, include d-Quotes and change the pegging functionality from pegging to the Exchange best bid or offer to pegging to the NBBO.<sup>7</sup>

As set forth in Rule 70.26(i), e-Quotes, other than tick-sensitive e-Quotes, may be set to peg to the NBB (for pegging interest to buy) or to the NBO (for pegging interest to sell) as the NBBO changes, so long as the NBBO is at or within the limit price. Rule 70.26(ii) specifies that d-Quotes may also employ pegging. Rule 70.26(iii) provides that pegging is active only when auto-quoting is active and that Exchange systems will reject e-Quotes that employ pegging that are entered 10 seconds or less before the scheduled close of trading. Rule 70.26(iv) provides that pegging e-Quotes and d-Quotes trade on parity with other interest at the NBBO after interest entitled to priority is executed, and Rule 70.26(vi) provides that a pegging e-Quote or d-Quote that sets the Exchange best bid or offer is entitled to priority.

Rule 70.26(v) provides that pegging is reactive, and that an e-Quote or d-Quote will not establish the NBBO as a result of pegging. Rule 70.26(vii) provides that pegging e-Quotes will only peg to non-pegging interest that is within the pegging range selected by the Floor broker,

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<sup>6</sup> See Securities Exchange Act Release No. 54577 (October 5, 2006), 71 FR 60208 (October 12, 2006) (SR-NYSE-2006-36). In 2008, the Exchange adopted the NYSE’s equity trading rules, including NYSE Rules 70.26 and 13. See Securities Exchange Act Release No. 58705 (October 1, 2008), 73 FR 58995 (October 8, 2008) (SR-Amex-2008-63).

<sup>7</sup> See Securities Exchange Act Release No. 61081 (December 1, 2009), 74 FR 64105 (December 7, 2009) (SR-NYSEAmex-2009-76).

and that such non-pegging interest may be available on the Exchange or be a protected bid or offer on an away market. Rule 70.26(viii) provides that an e-Quote or d-Quote will not sustain the NBBO as a result of pegging if there is no other non-pegged interest at that price, and such price is not the e-Quote's or d-Quote's limit price. Rule 70.26(viii)(A) and (B) provide that if a buy (sell) pegging e-Quote reaches its lowest (highest) quotable price and it is the NBB (NBO), such interest will remain displayed at the NBB (NBO) even if all other interest at that price cancels. Rule 70.26(ix) further provides detail of definitions of the price range that a Floor broker may designate for pegging e-Quotes, which is a price range that a Floor broker can add that is in addition to the limit price for the pegging e-Quote, provided that it is not inconsistent with the order's limit price.

Rule 70.26(x) provides that pegging interest will join the NBB or NBO provided that it is within the e-Quote's pegging range. As noted in Rule 70.26(x)(A), a pegging e-Quote will not join the NBBO if it is locking or crossing the Exchange best bid or offer, in which case the pegging e-Quote would peg to the next available best-priced non-pegging interest. Rule 70.26(x)(B) further provides that if the NBBO is not within the price range specified for the pegging e-Quote, it will peg to the next available best-priced non-pegging interest within the price range selected by the Floor broker.

Rule 70.26(xi) also provides that if a pegging range has not been included, the pegging e-Quote will peg to the NBBO so long as the NBBO is within the limit price of the e-Quote. Rule 70.26(xii) provides that the discretionary price range of a d-Quote will move with a pegging d-Quote, subject to any floor or ceiling set by the Floor broker. Rule 70.26(xii)(A) – (C) then set forth that if the NBBO moves out of the range of the pegging e-Quote, the pegging e-Quote will remain at the best price to which there may be non-pegging interest to peg, and that once the

NBBO returns to within the price range designated for the pegging e-Quote, it will once again peg to the NBBO. Finally, Rule 70.26(xiii) provides that a Floor broker may establish a minimum size of same-side volume to which the e-Quote or d-Quote will peg.

#### Summary of Proposed Rule Changes

As noted above, the Exchange proposes to permit DMM interest to be set as pegging interest. Because pegging for DMM interest would generally be the same as pegging for e-Quotes and d-Quotes, the Exchange proposes to amend the existing text, as described in more detail below, to define the term “pegging interest” to include e-Quotes, d-Quotes, and DMM interest.<sup>8</sup> The Exchange believes that it is appropriate to expand the availability of pegging interest to DMM interest because it will assist DMMs in meeting their obligations pursuant to Rule 104(a)(1) - Equities to maintain a continuous, two-sided quote at or near the NBBO throughout the trading day.

In particular, the Exchange notes that other markets have recently been approved to provide market makers with pegging order functionality so that market makers may automatically track the NBBO in compliance with the market-wide market maker quoting requirements.<sup>9</sup> The rules adopted or proposed by those markets set the pegging functionality to automatically track the designated percentages set forth in the market-wide quoting rule (i.e., Rule 104(a)(1)(B)(iii) - Equities designated percentages). While the Exchange’s expansion of

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<sup>8</sup> Trading interest that has been set to peg, i.e., e-Quotes, d-Quotes, and DMM interest, will be referred to collectively as “pegging interest.”

<sup>9</sup> See, e.g., Securities Exchange Act Release Nos. 67584 (Aug. 2, 2012), 77 FR 47472 (Aug. 8, 2012) (SR-NASDAQ-2012-066) (approving The NASDAQ Stock Market LLC (“Nasdaq”) Rule 4751(f)(15), which establishes a “Market Maker Peg Order”); 67756 (Aug. 29, 2012), 77 FR 54633 (Sept. 5, 2012) (SR-BATS-2012-026) (approving The BATS Exchange, Inc. (“BATS”) Rule 11.8(e), which establishes a “Market Maker Peg Order”); and 67755 (Aug. 29, 2012), 77 FR 54630 (Sept. 5, 2012) (SR-BYX-2012-012) (approving BATS-Y Exchange, Inc. (“BYX”) Rule 11.8(e), which establishes a Market Maker Peg Order).

pegging functionality to DMMs would not include those set percentages, the Exchange believes that providing DMMs with the flexibility to engage in same-side or opposite-side pegging with offset values of their own choosing, as discussed in more detail below, will enable DMMs to set their market-making quoting interest to automatically track the PBBO at a tighter ratio than the quoting requirements contemplated by Rule 104(a)(1)(B) - Equities.<sup>10</sup>

The Exchange also proposes to change references to NBB, NBO and NBBO throughout Rule 70.26 to PBB, PBO and PBBO, respectively. The Exchange believes that these changes are more consistent with the requirements of the Regulation NMS Order Protection Rule<sup>11</sup> and the related definition of protected bid and offer, as set forth in Regulation NMS Rule 600(b)(57),<sup>12</sup> which defines a protected bid or protected offer as a quote in an NMS stock that is (i) displayed

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<sup>10</sup> Member organizations are responsible for determining whether their trading activity qualifies as bona fide market making for purposes of the “locate” exception and close-out requirements of Regulation SHO under the Exchange Act. Compliance with the quoting requirements of Rule 104(a)(1)(B) - Equities, or any other rules of the Exchange, does not necessarily mean that the DMM, or other form of Exchange-registered market maker, is engaged in bona fide market making for purposes of Regulation SHO. *See* 17 CFR 242.203(b)(2)(iii); 17 CFR 242.204(a)(3). The Commission adopted a narrow exception to Regulation SHO’s “locate” requirement for market makers that may need to facilitate customer orders in a fast moving market without possible delays associated with complying with such requirement. Only market makers engaged in bona fide market making in the security at the time they effect the short sale are excepted from the “locate” requirement. *See* Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48015 (August 6, 2004) (providing guidance as to what does not constitute bona fide market making for purposes of claiming the exception to Regulation SHO’s “locate” requirement). *See also* Exchange Act Release No. 58775 (October 14, 2008), 73 FR 61690, 61698-9 (October 17, 2008) (providing guidance regarding what is bona fide market making for purposes of complying with the market maker exception to Regulation SHO’s “locate” requirement including without limitation whether the market maker incurs any economic or market risk with respect to the securities, continuous quotations that are at or near the market on both sides and that are communicated and represented in a way that makes them widely accessible to investors and other broker-dealers and a pattern of trading that includes both purchases and sales in roughly comparable amounts to provide liquidity to customers or other broker-dealers).

<sup>11</sup> 17 CFR 242.611.

<sup>12</sup> 17 CFR 242.600(b)(57).

by an automated trading center; (ii) disseminated pursuant to an effective national market system plan; and (iii) an automated quotation that is the best bid or best offer of a national stock exchange or a national securities association. Exchange systems monitor the PBBO for purposes of the Order Protection Rule and, in this respect, Exchange systems also move pegging interest based on moves to the PBBO, not the NBBO.<sup>13</sup>

The Exchange further proposes to expand the pegging functionality to permit pegging to the opposite side of the market. The existing functionality, for which pegging interest to buy (sell) pegs to the PBB (PBO), would be renamed in the rule as a “Primary Pegging Interest.”<sup>14</sup> The proposed new functionality, whereby pegging interest would peg to the opposite side of the market (buy (sell) pegs to the PBO (PBB)) would be referred to in the proposed rule as a “Market Pegging Interest.”<sup>15</sup> The Exchange believes that adding Market Pegging Interest functionality would contribute to narrower spreads for securities and is consistent with approved rules of other markets.<sup>16</sup>

The Exchange also proposes to provide for an offset value, which would be a specified amount by which the price of pegging interest would differ from the price of the interest to which it pegs.<sup>17</sup> The Exchange proposes to specify that an offset value would be optional for

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<sup>13</sup> In most instances, the PBBO and the NBBO are the same. However, if the NBBO is based on a quote that is no longer protected, i.e., a stale quote, the PBBO may change before the NBBO changes. In this regard, the Exchange notes that current Rule 70.26(vii) already specifies that pegging interest may peg to interest available on the Exchange or a protected bid or offer on an away market.

<sup>14</sup> See proposed paragraph (c) of the pegging interest text of Rule 13.

<sup>15</sup> See proposed paragraph (d) of the pegging interest text of Rule 13.

<sup>16</sup> See, e.g., Nasdaq Rule 4751(f) and BATS Rule 11.9(c)(8).

<sup>17</sup> See proposed paragraph (b) of the pegging interest text of Rule 13.

Primary Pegging Interest,<sup>18</sup> but would be required for Market Pegging Interest.<sup>19</sup> As proposed, when applying an offset value to Primary Pegging Interest, the adjusted price for buy (sell) pegging interest would be the PBB (PBO) minus (plus) the offset value. When applying the offset value to Market Pegging Interest, the adjusted price for buy (sell) pegging interest would be the PBO (PBB) minus (plus) the offset value.<sup>20</sup> If the offset value of pegging interest to buy (sell) would result in a price that is greater than \$1.00 in an increment smaller than \$0.01, the price of the pegging interest to buy (sell) would be rounded down (up) to the nearest permissible minimum price variation, consistent with Rule 61 - Equities.<sup>21</sup>

The Exchange believes that adding Market Pegging functionality would enable pegging interest to potentially establish a better price than is currently available, thereby reducing the size

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<sup>18</sup> See proposed paragraph (c)(4) of the pegging interest text of Rule 13.

<sup>19</sup> See proposed paragraph (d)(4) of the pegging interest text of Rule 13. Because an offset value would be required for Market Pegging Interest, Exchange systems would reject Market Pegging Interest that does not include an offset value.

<sup>20</sup> For example, if the PBB is \$2.00 and the PBO is \$2.05, pegging interest to buy that is set to peg to the same side of the market with an offset of \$0.01 would be priced at \$1.99 (i.e., \$2.00 PBB minus \$0.01 offset). Pegging interest to sell that is set to peg to the same side of the market with an offset of \$0.01 would be priced at \$2.06 (i.e., \$2.05 PBO plus \$0.01 offset). In contrast, pegging interest to buy that is set to peg to the opposite side of the market with an offset of \$0.05 would be priced at \$2.00 (i.e., \$2.05 PBO minus \$0.05 offset). Pegging interest to sell that is set to peg to the opposite side of the market with an offset of \$0.05 would be priced at \$2.05 (i.e., \$2.00 PBB plus \$0.05 offset).

<sup>21</sup> Continuing with the example above, if the PBB is \$2.00 and the PBO is \$2.05, pegging interest to buy that is set to peg to the same side of the market with an offset of \$0.015 would be priced at \$1.98 (i.e., \$2.00 PBB minus \$0.015 offset equals \$1.985 and rounded down to nearest permissible minimum price variation). Pegging interest to sell that is set to peg to the same side of the market with an offset of \$0.015 it would be priced at \$2.07 (i.e., \$2.05 PBO plus \$0.015 offset equals \$2.065 and rounded up to nearest permissible minimum price variation). In contrast, pegging interest to buy that is set to peg to the opposite side of the market with an offset of \$0.015 would be priced at \$2.03 (i.e., \$2.05 PBO minus \$0.015 offset equals \$2.035 and rounded down to nearest permissible minimum price variation). Pegging interest to sell that is set to peg to the opposite side of the market with an offset of \$0.015 would be priced at \$2.02 (i.e., \$2.00 PBB plus \$0.015 offset equals \$2.015 and rounded up to nearest permissible minimum price variation).



of the spread for a security. For example, if the PBBO in a security is \$10.05 – \$10.07, and the buy pegging interest is pegged to the PBO with an offset of \$0.01, the buy pegging interest would post on the Exchange as a \$10.06 bid, which would be a new PBB that reduces the spread and creates a tighter market. The Exchange notes that unlike Primary Pegging Interest, which currently cannot establish or sustain the PBBO as a result of pegging, Market Pegging Interest can establish or sustain a PBB or PBO.

#### Proposed Specific Rule Changes

As noted above, the Exchange proposes to delete Rule 70.26 in its entirety and move the text that provides for pegging to Rule 13. Because pegging interest is being expanded to include DMM interest, the Exchange believes that Rule 70, which concerns Floor broker interest only, is no longer the proper rule within which to provide for pegging. Rather, because pegging is a type of modifier, the Exchange believes it is more appropriate to provide for pegging within Rule 13 as a defined term referred to as “pegging interest.” The Exchange notes that Rule 13 is currently titled “Definition of Orders.” However, Rule 13 currently provides for orders *and* order modifiers.<sup>22</sup> Accordingly, the Exchange proposes to change the title of Rule 13 to “Orders and Modifiers.”

As proposed, the new pegging interest section of Rule 13 would replace the existing text of Rule 70.26, with numerous non-substantive changes, as well as add new rule text to incorporate the elements proposed above, i.e., permitting DMM interest to be set as pegging interest, changing NBBO to PBBO, adding the Market Pegging Interest functionality, and providing for an offset value to be specified. The Exchange believes that the proposed changes to the rule text, as incorporated in Rule 13, result in a more streamlined rule that eliminates

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<sup>22</sup> For example, a sell “plus” or buy “minus” order is not an order type per se, but is instead an order modifier.

redundancy in the current rule while also incorporating the new elements in a logical and comprehensive manner. For example, rather than referring to “pegging e-Quotes” or “pegging d-Quotes” throughout the rule, the Exchange proposes to use the term “pegging interest,” unless the rule is specific only to a particular type of interest. In addition, the Exchange proposes to combine concepts that are currently addressed separately or in multiple locations within Rule 70.26, but that can be logically combined into streamlined rule text (e.g., the text discussing the permissible price range and how it impacts pegging).

The following sets forth the proposed rule changes (all references to proposed paragraphs are to the proposed new pegging interest text of Rule 13):

- Proposed paragraph (a) provides that “pegging interest” means displayable or non-displayable interest to buy or sell at a price set to track the PBB or PBO as the PBBO changes. The proposed rule text would replace the general description of pegging in Rule 70.26(i), with certain changes. As discussed above, from a substantive perspective, the Exchange proposes to replace references to the NBB, NBO, and NBBO with references to the PBB, PBO, and PBBO. The Exchange proposes to delete the reference to the limit price of an e-Quote as that concept will now be part of proposed paragraph (a)(4), relating to the specified price range of pegging interest. In addition, the Exchange proposes a clarifying rule change to add that pegging interest may be for displayable or non-displayable interest. The current pegging functionality is available for all e-Quotes and d-Quotes, whether intended for display or not, and the Exchange proposes a clarifying rule change to make clear that pegging interest is available for both displayable and non-displayable interest.

- Proposed paragraph (a)(1) provides that pegging interest can be an e-Quote, d-Quote, or DMM Interest. The proposed rule text would replace without any substantive change rule text from Rule 70.26(i) referencing e-Quotes and Rule 70.26(ii), which references d-Quotes. The proposal to add DMM interest is new rule text, as described in more detail above.
- Proposed paragraph (a)(1)(A) provides that pegging interest may not include a sell “plus” or buy “minus” instruction, which replaces without any substantive change the current text in Rule 70.26(i) that a tick-sensitive e-Quote is not permitted to peg. A “tick sensitive” e-Quote is one that includes a sell “plus” or buy “minus” instruction, which are existing defined terms in Rule 13. Therefore, the Exchange proposes to use the sell “plus” or buy “minus” terminology instead of the current “tick sensitive” language, which is not a defined term in Exchange rules.<sup>23</sup>
- Proposed paragraph (a)(1)(B) would replace without any substantive change the second sentence of Rule 70.26(iii), which provides that Exchange systems shall reject a pegging e-Quote or d-Quote that is entered 10 seconds or less before the scheduled close of trading.<sup>24</sup> The Exchange notes that the rationale for excluding pegging e-Quotes and d-Quotes 10 seconds prior to the close is to assist the DMM with arranging the close, and because the DMM is aware of DMM interest, this prohibition is not necessary for DMM interest. The Exchange notes that this does not confer any additional benefit to the DMM because the DMM may be required to supply

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<sup>23</sup> This change does not alter the meaning of the current rule text.

<sup>24</sup> The current rule text only refers to e-Quotes, but since d-Quotes are a subset of e-Quotes, Exchange systems currently reject both pegging e-Quotes and d-Quotes that are entered 10 seconds or less before the scheduled close of trading.

additional liquidity as needed as part of the closing transaction in order to meet the obligation set forth in Rule 104(a)(3) - Equities to facilitate the close of trading for each of the securities in which the DMM is registered.

- Proposed paragraph (a)(1)(C) would replace without any substantive change Rule 70.26(xii) by specifying that discretionary instructions associated with a pegging d-Quote would move as the d-Quote pegs to the PBBO, subject to any price range and limit price that may be specified. The Exchange does not propose to include the reference to e-Quote that is currently in Rule 70.26(xii) because a d-Quote is an e-Quote with discretionary instructions.<sup>25</sup> Also, the Exchange proposes to refer to the specified price range instead of the current reference to floor or ceiling price in Rule 70.26(xii). Finally, the Exchange proposes to include a reference to the pegging interest's limit price. The Exchange notes that the textual differences between proposed paragraph (a)(1)(C) and current Rule 70.26(xii) do not make any substantive changes to the rule.
- Proposed paragraph (a)(2) would replace without any substantive change the first sentence of Rule 70.26(iii), by specifying that pegging is only active when auto-quoting is active.
- Proposed paragraph (a)(3) would replace the rule text in Rule 70.26(vii) by specifying that pegging interest shall peg to a price that is based on either (A) a protected bid or offer, which may be available on the Exchange or an away market, or (B) interest that establishes a price on the Exchange, which may include Primary or Market Pegging Interest that has established a price as a result of an offset value. The current rule

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See supra note 5.

provides that pegging interest only pegs to other non-pegging interest, which may be available on the Exchange or a protected bid or offer on an away market. The proposed rule text modifies the existing rule text to take into consideration the possibility that either Primary Pegging Interest or Market Pegging Interest may establish a price on the Exchange and therefore pegging interest may peg to other pegging interest.<sup>26</sup> The circumstances where pegging interest may establish a price is as a result of the proposed new offset function, which is why the Exchange proposes to change this aspect of the rule.

- Example 1: Assume that the Exchange best bid and offer, which is also the PBBO, is \$10.05 - \$10.07, and there is buy Market Pegging Interest pegged to the PBO with an offset value of \$0.01, such Market Pegging Interest would establish a new PBB and Exchange best bid of \$10.06. Because the Market Pegging Interest established a new PBB, Primary Pegging Interest to buy could peg to that \$10.06 price and therefore would be pegging to pegging interest.
- Example 2: Assume again that the Exchange best bid or offer, which is also the PBBO, is \$10.05 - \$10.07, with 100 shares at the bid, and there is buy Primary Pegging Interest “A” of 500 shares with an offset of \$0.01, which would be at a price of \$10.04, and that is the only Exchange interest priced at \$10.04. Assume further there is buy Primary Pegging Interest “B” that will only peg if there is minimum same-side volume of 500 shares.<sup>27</sup> Because the

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<sup>26</sup> See proposed paragraph (d)(2) of the pegging interest text of Rule 13.

<sup>27</sup> See proposed paragraph (c)(5) of the pegging interest text of Rule 13.

Exchange best bid is only 100 shares, Primary Pegging Interest “B” would peg to the price that meets the minimum size requirement, which in this case would be the price established by the Primary Pegging Interest “A” at \$10.04. In this scenario, because of the offset value associated with Primary Pegging Interest “A”, that interest has established a price and as a result, Primary Pegging Interest “B” is pegging to pegging interest.

- Proposed paragraph (a)(4) provides that pegging interest shall peg only within the specified price range for the pegging interest. The Exchange notes that while the proposed language is new rule text, the proposed paragraph does not make any substantive changes to the current rule, but rather consolidates rule text from separate parts of the existing rule in a streamlined format. In particular, the proposed rule would replace the remaining text in Rules 70.26(i) (that pegging interest must be within the e-Quote’s limit price), 70.26(vii) (that pegging interest pegs to interest within the price range selected by the Floor broker), and 70.26(ix), including (A) through (D) of that subsection, by replacing the detailed “price range” discussion within current Rule 70.26(ix) by specifying instead that pegging interest shall peg only within the specified price range for the pegging interest. For example, Rule 70.26(ix)(D) currently specifies that the price to which pegging interest pegs cannot be higher (lower) than the limit price of the buy (sell) pegging interest, which is also currently covered in Rule 70.26(i).<sup>28</sup> In this regard, the Exchange proposes not to

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<sup>28</sup> This addition would not result in a substantive change to pegging. Also, the Exchange notes that Rule 70.26(ix) currently says that the price may not be “inconsistent with” the limit price. The Exchange believes that using “specified price range” would be clearer than the current “inconsistent with” text because the specified price range concept is broad enough to include the limit price of the order as well as any other pricing

include the text of current Rule 70.26(ix)(A), (B) and (C), which refer to the “quote price,” “ceiling price” and “floor price,” respectively, of pegging interest. The Exchange does not consider these terms necessary and believes that proposed paragraph (a)(4) is clearer and more streamlined without their inclusion.<sup>29</sup>

- Proposed paragraph (a)(4)(A) specifies that if the PBBO, combined with any offset value, is not within the specified price range, the pegging interest would instead peg to the next available best-priced interest that is within the specified price range. Other than addressing how the offset value impacts the pegging interest, the reference to NBBO changing to PBBO, replacing the phrase “the price range selected by the Floor broker” with “the specified price range,” this text is substantively the same and replaces current Rule 70.26(x)(B).<sup>30</sup>
- Proposed paragraph (a)(4)(B) would replace without any substantive change the current Rule 70.26(xii)(A), (B) and (C) by specifying that pegging interest that has reached its specified price range will remain at that price if the PBBO goes beyond such price range and that if the PBBO returns to a price within the specified price range, it shall resume pegging. The Exchange notes that this text is substantively the same as in current Rule 70.26(xii)(A), (B), and (C), albeit in a streamlined format. The Exchange further notes that the proposed rule text replaces without any substantive change concepts set forth in Rule 70.26(x) (that pegging interest will peg

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instructions that may be included with the pegging interest.

<sup>29</sup> The Exchange considers it inherent that a price “range” will have upper and lower bounds and therefore does not consider these terms necessary.

<sup>30</sup> The Exchange notes that Rule 70.26(x)(B) provides that pegging interest will “join” the interest to which it pegs. The Exchange believes that using “peg to” terminology would be more precise than the current “join” language.

- to the NBBO so long as it is in the specified price range) and 70.26(xi) (pegging interest without a specified price range will peg based on the limit price of the order).
- Proposed paragraph (b) defines the “offset value,” as discussed in more detail above.
  - Proposed paragraph (c) defines the term “Primary Pegging Interest,” as discussed in more detail above.
  - Proposed paragraph (c)(1) would replace Rule 70.26(x)(A) by specifying that Primary Pegging Interest shall not peg to a price that is locking or crossing the Exchange best offer (bid), but instead would peg to the next available best-priced interest that would not lock or cross the Exchange best offer (bid). In moving the text from Rule 70.26(x)(A), the Exchange proposes two minor changes: to change the reference from the NBB (NBO) to the term “price” and to delete the term “non-pegging interest.”
- The Exchange proposes these modifications because, as discussed above in connection with proposed paragraph (a)(3), there may be circumstances where because of the offset value, pegging interest may peg to a price established by pegging interest, which in some cases, may not be the PBBO.
- Proposed paragraph (c)(2) would replace without substantive change Rules 70.26(v), (viii), (viii)(A), and (viii)(B) by specifying that Primary Pegging Interest will not establish a PBB (PBO) or sustain a PBB (PBO) as a result of pegging.<sup>31</sup>

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<sup>31</sup> The Exchange believes that the proposed rule text “as a result of pegging” clarifies that the only time that Primary Pegging Interest will not establish or sustain the PBBO is if it is following its pegging instructions. When a Primary Pegging Interest is at a price because it is the limit price of the Primary Pegging Interest, such interest will not have established or sustained the PBBO “as a result of pegging” and the Exchange believes that it is no longer necessary to specifically state that pegging interest at its limit price may remain displayed at the PBBO, as currently set forth in Rules 70.26(viii)(A) and (B). In addition, the Exchange proposes not to replace the statement in Rule 70.26(v) that pegging is reactive because that concept was intended to mean that pegging interest



- Proposed paragraph (c)(3) would replace without any substantive change Rule 70.26(vi) by specifying that Primary Pegging Interest may establish an Exchange best bid or offer. The Exchange proposes to replace the rule text set forth in Rule 70.26(vi) that pegging interest that sets the Exchange best bid or offer is entitled to priority by adding to Rule 72 - Equities that pegging interest may have priority interest.<sup>32</sup>
- Proposed paragraph (c)(4) provides that Primary Pegging Interest may include an offset value for which the adjusted price for buy (sell) pegging interest shall be the PBB (PBO) minus (plus) the offset value, which is new rule text, as discussed in greater detail above.
- Proposed paragraph (c)(5) would replace without any substantive change Rule 70.26(xiii) by specifying that Primary Pegging Interest may be designated with a minimum size of same-side volume to which such pegging interest shall peg. Other than the references to NBB and NBO changing to PBB and PBO, respectively, this text is substantively the same as in current Rule 70.26(xiii).
- Proposed paragraph (d) provides for new rule text related to the new Market Pegging Interest, which is discussed in greater detail above. More specifically, proposed paragraph (d)(1) would provide that Market Pegging Interest shall not peg to a price

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cannot create a PBB or PBO. However, because proposed Market Pegging Interest can establish a new PBB or PBO, the limitation to “reactive” is no longer relevant and the Exchange believes that the proposed rule text that Primary Pegging Interest cannot establish or sustain the PBBO obviates the need to separately say that pegging is reactive. The Exchange also proposes to delete the term “new” as being redundant of the concept of establishing a PBB or PBO.

<sup>32</sup> The Exchange proposes to further amend Rule 72 - Equities to change a reference to current Rule 70.26 to the proposed new pegging interest text within Rule 13 and change a reference to e-Quotes to “pegging interest,” generally.

that is locking or crossing the Exchange best offer (bid), but instead shall peg to a price one minimum price variation lower (higher) than the Exchange best bid or offer. This proposed functionality is intended to prevent Market Pegging Interest from locking or crossing the Exchange best bid or offer.<sup>33</sup> Proposed paragraph (d)(2) would provide that Market Pegging Interest to buy (sell) may establish or sustain a PBB (PBO). Proposed paragraph (d)(3) would mirror paragraph (c)(3) by specifying that Market Pegging Interest may establish an Exchange best bid or offer. Finally, proposed paragraph (d)(4), would require Market Pegging Interest to include an offset value, as discussed in more detail above.

The Exchange proposes to delete without replacing Rule 70.26(iv), which provides that pegging interest trades on parity with other interest at the NBBO after interest entitled to priority is executed. The Exchange believes that this text is superfluous, in that pegging interest is not treated differently than non-pegging interest for purposes of determining parity, as set forth in Rule 72 - Equities, and Rule 72 - Equities governs the allocation of executions and priority.<sup>34</sup> The Exchange therefore is not proposing to address this concept in new pegging interest section

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<sup>33</sup> A potential scenario when Market Pegging Interest could lock or cross the Exchange best bid or offer could be if a liquidity replenishment point (“LRP”) is reached pursuant to Rule 1000 - Equities, and automatic executions on one side of the market are suspended at the Exchange. In such scenario, assume that the Exchange best bid is \$10.04, an LRP is reached and the Exchange is slow on the buy side, a new PBB is published at \$10.03, and there is Market Pegging Interest to sell with a \$0.01 offset. Because the Market Pegging Interest to sell would peg to the PBB priced at \$10.03, with a penny offset, and lock the Exchange’s best bid at \$10.04, the Exchange proposes to reprice the Market Pegging Interest to sell to \$10.05 so that it does not lock the Exchange best bid.

<sup>34</sup> The Exchange proposes to amend Rule 72(a)(i) - Equities and (ii) - Equities to specify that displayable interest may include pegging interest. Because pegging interest would be included as “displayable interest,” the description of allocation of orders would not include pegging interest with any reference to displayable interest. The Exchange also proposes conforming edits to Rule 72(a)(ii)(G) - Equities to replace references to Rule 70.26 and e-Quotes with references to Rule 13 and “pegging interest.”

of Rule 13.

The Exchange further proposes to add new subsection (xii) to Rule 72(c) - Equities to codify how Exchange systems treat modifications to orders for purposes of time sequencing. Specifically, if an order is modified solely to reduce the size of the order, Exchange systems accept such a modification without changing the time stamp of original order entry.<sup>35</sup>

Accordingly, the Exchange proposes to codify in Rule 72(c)(xii) - Equities that an order that is modified to reduce the size of the order shall retain the time stamp of original order entry.

Currently, any other modification to an order, including increasing the size of the order or changing the price of the order, results in the order receiving a new time stamp. Accordingly, the Exchange proposes to codify that any other modification of an order, such as increasing the size or changing the price of an order, shall receive a new time stamp. The Exchange notes that the proposed rule language covers any modification of an order, whether directed by a member organization that entered the order or entered by Exchange systems pursuant to rule.<sup>36</sup> For example, Exchange systems may re-price an order if the interest is being re-priced because it is

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<sup>35</sup> The manner by which a member organization may reduce the size of an order without impacting the time stamp is to submit a partial cancellation message. For example, if a member organization has entered an order for 400 shares to buy at \$10.00 and wants to reduce it to 200 shares to buy at \$10.00, the member organization would submit a cancel message for 200 shares to buy at \$10.00, which would leave the remaining 200 shares of the buy order with the time stamp of original order entry.

<sup>36</sup> To change the price of an order or increase the size of an order, a member organization would need to enter a “cancel/replace” message, which serves to cancel the original order and replace it with a new order. The replacement order receives a new time stamp. The “cancel/replace” message can also be used to change the order marking under Regulation SHO of a pending sell order (i.e., from “long” to “short”). For example, if a seller increases the size of a pending sell order, the resulting modified order is considered a new order and must be marked by the broker-dealer to reflect the seller’s net position at the time of order modification pursuant to Rule 200 of Regulation SHO. The Exchange notes that if a member organization uses a “cancel/replace” message to reduce the size of the order, rather than a partial cancellation, because the “cancel/replace” message cancels the original order in its entirety, the replacement order would receive a new time stamp, even if the replacement order represents only a reduction in size of the order.

pegging interest, pursuant to Rule 13, or because it is a short sale order during a Short Sale Period, pursuant to Rule 440B(e) - Equities.

The proposed changes to Rule 72(c)(xii) - Equities will be effective on the operative date of this filing. The Exchange will announce the implementation date of the proposed rule change as it relates to pegging interest changes in a Trader Update to be published no later than 90 days following publication of the notice in the Federal Register. The implementation date will be no later than 90 days following publication of the Trader Update announcing publication of the notice in the Federal Register.

## 2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Securities Exchange Act of 1934 (the “Act”),<sup>37</sup> in general, and furthers the objectives of Section 6(b)(5),<sup>38</sup> in particular, because it is 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 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 is also not designed to permit unfair discrimination.

The Exchange believes that expanding the pegging functionality to DMM interest is consistent with the Act because it will remove impediments to, and perfect the mechanism of a free and open market and national market system and, in general, protect investors and the public interest by providing a mechanism for DMMs to assist them with meeting their market-making obligations to maintain quoting interest at or near the NBBO. The Exchange notes that two other markets have been approved to offer pegging functionality expressly for market makers for a

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<sup>37</sup> 15 U.S.C. 78f(b).

<sup>38</sup> 15 U.S.C. 78f(b)(5).

similar purpose.<sup>39</sup> The Exchange's proposal differs because as proposed, the DMM would be able to select whether to enter Primary Pegging Interest or Market Pegging Interest, and would be able to select the offset value, thereby providing the DMM with flexibility to track the PBBO at a tighter ratio than contemplated by the rules of other exchanges that offer a market maker pegging functionality.

The Exchange further notes that expanding pegging functionality to DMM interest is not designed to permit unfair discrimination. The Exchange believes that expanding the functionality to DMMs is consistent with the existing approved rules, as well as consistent with the Act because the expansion is narrowly tailored to offer the functionality to a class of participants that has an affirmative obligation to maintain a quote at or near the NBBO.<sup>40</sup> The Exchange notes that another class of member organizations, Supplemental Liquidity Providers ("SLP"), provide liquidity to the Exchange, and certain SLPs can register as market makers at the Exchange.<sup>41</sup> While the Market Pegging Interest functionality will not be available to SLPs at this time, the Exchange does not believe that this is discriminatory because there is no requirement that a security be assigned to an SLP, and a member organization's participation in the SLP program is voluntary. By contrast, all securities traded at the Exchange must be assigned to a DMM, and a DMM unit cannot withdraw from registration in securities assigned to it.

As discussed above, rather than adding the concepts for the Market Peg functionality, the offset value, and expansion to DMM interest in Rule 70.26, the Exchange proposes to restructure the text of Rule 70.26 and move it to Rule 13. The Exchange believes that this will more

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<sup>39</sup> See *supra* note 9.

<sup>40</sup> See Rule 104(a)(1)(A) - Equities.

<sup>41</sup> See Rule 107B - Equities.

appropriately address how pegging operates and consolidates rule text relating to orders and modifiers in single location in the rules. In this regard, the proposal to change references to NBB, NBO and NBBO to PBB, PBO and PBBO, respectively, would add greater specificity regarding the interest to which pegging interest may peg. The Exchange also believes that these changes are more consistent with the requirements of the Regulation NMS Order Protection Rule<sup>42</sup> and the related definition of protected bid and offer, as set forth in Regulation NMS Rule 600(b)(57).<sup>43</sup> As noted above, Exchange systems monitor the PBBO for purposes of the Order Protection Rule and, in this respect, Exchange systems also move pegging interest based on moves to the PBBO, not the NBBO.<sup>44</sup> The Exchange believes that this increased specificity would perfect the mechanism of a free and open market and a national market system and, in general, would protect investors and the public interest.

Additionally, use of the proposed Market Pegging Interest with an offset value, as well as the proposed offset functionality for Primary Pegging Interest, would provide greater flexibility with respect to the price to which pegging interest may peg and would encourage tighter spreads that move as the PBBO moves. The Exchange believes that this would remove impediments to, and perfect the mechanism of, a free and open market and a national market system.

Additionally, requiring an offset value to be specified for pegging interest that pegs to the opposite side of the market would prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and foster cooperation and coordination with persons engaged in facilitating transactions in securities by preventing pegging interest from

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<sup>42</sup> See supra note 10.

<sup>43</sup> See supra note 11.

<sup>44</sup> See supra note 12.

locking or crossing the opposite side of the market. The Exchange further believes that the proposal fosters competition as other markets already offer similar functionality.

The Exchange also believes that the proposed rule change would promote clarity and transparency by adding greater specificity with respect to the interest to which pegging interest may peg. In this regard, the proposed realignment and consolidation of existing rule text would result in a clearer rule, which would benefit all member organizations as well as others that read the rule.

The Exchange further believes that the proposed rule change would promote clarity and transparency by removing superfluous rule text that merely describes the manner in which all trading interest is treated, regardless of whether it is pegging interest. For example, removing the text within current Rule 70.26(iv), which provides that pegging interest trades on parity with non-pegging interest, would eliminate potential confusion regarding whether pegging interest is treated differently than non-pegging interest with respect to determining parity.

Finally, the Exchange believes that the proposed change to Rule 72 -Equities to codify which modifications to an order that Exchange systems accept and time stamp treatment for such modified orders would promote clarity and transparency and therefore remove impediments to, and perfect the mechanism of, a free and open market and a national market system because the proposed rule change makes clear when a modification to an order results in a new time stamp for that order.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change or such shorter time as designated by the Commission, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>45</sup> and Rule 19b-4(f)(6) thereunder.<sup>46</sup>

At any time within 60 days of the filing of such proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

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<sup>45</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>46</sup> 17 CFR 240.19b-4(f)(6).



- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NYSEMKT-2012-67 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSEMKT-2012-67. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer

to File Number SR-NYSEMKT-2012-67 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>47</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>47</sup> 17 C.F.R. 200.30-3(a)(12).