

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-70303)

September 3, 2013

Order Exempting Broker-Dealers Participating in NYSE Arca, Inc.'s Lead Market Maker Incentive Program from Section 11(d)(1) of the Securities Exchange Act of 1934 and Rule 11d1-2 thereunder

On June 6, 2013, the Securities and Exchange Commission (“Commission”) approved a proposed rule change of NYSE Arca, Inc. (“Exchange” or “NYSE Arca”) to adopt new NYSE Arca Equities Rule 8.800 (“Rule 8.800”). Rule 8.800 establishes an incentive program on a pilot basis (“Incentive Program”) for Lead Market Makers (“LMMs”) in certain exchange-traded products (“ETPs”).¹ The Incentive Program is designed to encourage market makers to take LMM assignments in certain lower volume ETPs by offering an alternative fee structure for those LMMs and “LMM Payments” that would be funded from the Exchange’s general revenues if the LMM meets or exceeds certain performance standards set forth in Rule 8.800(c) that relate to the LMM’s quoting activity in the ETP. The costs of the Incentive Program would be funded by charging participating issuers non-refundable “Optional Incentive Fees” which may be paid by sponsors on behalf of the issuer.

¹ Securities Exchange Act Release No. 69706 (June 6, 2013), 78 FR 35340 (June 12, 2013) (SR-NYSEArca-2013-34) (the “Approval Order”). The Approval Order contains a detailed description of the Incentive Program. On March 21, 2013, the Exchange filed with the Commission, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, as amended (“Act” or “Exchange Act”) and Rule 19b-4 thereunder, a proposed rule change to establish the Program. The proposed rule change, as modified by Amendment No. 1 thereto, was published for comment in the Federal Register on April 11, 2013. Securities Exchange Act Release No. 69335 (Apr. 5, 2013), 78 FR 21681 (Apr. 11, 2013). The Approval Order grants approval of the proposed rule change, as modified by Amendments No. 1 and 2.

Section 11(d)(1) of the Exchange Act² generally prohibits a broker-dealer from extending or maintaining credit, or arranging for the extension or maintenance of credit, on shares of new issue securities, if the broker-dealer participated in the distribution of the new issue securities within the preceding 30 days. Shares of open-end investment companies and unit investment trusts registered under the Investment Company Act of 1940, such as exchange traded fund (“ETF”) shares, are distributed in a continuous manner. Broker-dealers that sell such securities are therefore participating in the “distribution” of a new issue for purposes of Section 11(d)(1).³

The Division of Trading and Markets, acting under delegated authority, granted an exemption from Section 11(d)(1) and Rule 11d1-2 thereunder to broker-dealers that have entered into an agreement with an ETF’s distributor to place orders with the distributor to purchase or redeem the ETF’s shares (“Broker-Dealer APs”).⁴ The SIA Exemption allows a Broker-Dealer AP to extend or maintain credit, or arrange for the extension or maintenance of credit, to or for customers on the shares of qualifying ETFs subject to the condition that neither the Broker-Dealer AP, nor any natural person associated with the Broker-Dealer AP, directly or indirectly (including through any affiliate of the Broker-Dealer AP), receives from the fund complex any payment, compensation, or other economic incentive to promote or sell the shares of the ETF to persons outside the fund complex, other than non-cash compensation permitted under NASD Rule 2830(l)(5)(A), (B), or (C). This condition is intended to eliminate special incentives that Broker-Dealer APs and their associated persons might otherwise have to “push” ETF shares.

² 15 U.S.C. 78k(d)(1).

³ See, e.g., Exchange Act Release Nos. 6726 (Feb. 8, 1962), 27 FR 1415 (Feb. 15, 1962) and 21577 (Dec. 18, 1984), 49 FR 50174 (Dec. 27, 1984).

⁴ See Letter from Catherine McGuire, Chief Counsel, Division of Trading and Markets, Securities and Exchange Commission to Securities Industry Association (Nov. 21, 2005) (“SIA Exemption”).

The Incentive Program will permit certain ETPs, including ETFs and commodity-based exchange traded trusts, to voluntarily incur increased listing fees payable to the Exchange. In turn, the Exchange will use a portion of the fees to make LMM Payments to market makers that improve the market quality of participating issuers' securities.⁵ LMM Payments will be accrued solely for quoting activity on the Exchange. Broker-dealers receiving the incentive payments would not be in compliance with the compensation condition of the SIA Exemption discussed above.⁶ Therefore, an LMM that is also a Broker-Dealer AP for an ETF (or an associated person or an affiliate of a Broker-Dealer AP) that receives the incentives will not be able to rely on the SIA Exemption from Section 11(d)(1).⁷

⁵ Among other things, the Incentive Program requires LMMs to: (1) maintain continuous, two-sided trading interest where the price of the bid (offer) interest is not more than a designated percentage away from the then current NBBO; (2) maintain quotes or orders at the NBBO or better (the "Inside") during the month during Core Trading Hours in accordance with certain maximum width and minimum depth thresholds based on daily share volume and share price, unless the thresholds are otherwise met by quotes or orders of all market participants across all markets trading the security; (3) maintain quotes or orders on NYSE Arca at the NBBO that meet either a time-at-the-Inside requirement or a size-setting NBBO requirement; and (4) for at least 90% of the time when quotes may be entered during Core Trading Hours each trading day, as averaged over the course of a month, maintain (A) at least 2,500 shares of attributable, displayed posted buy liquidity on the Exchange that is priced no more than 2% away from the NBB for the particular ETP; and (B) at least 2,500 shares of attributable, displayed posted offer liquidity on the Exchange that is priced no more than 2% away from the NBO for the particular ETP. If an LMM does not meet these quoting requirements, it will not receive an LMM Payment, and an LMM that does not meet or exceed these performance standards for any two of the three months of a quarter or for five months during the pilot period may lose its LMM status. Request Letter at 5.

⁶ The incentive payments market makers may receive under Rule 8.800 are indirect payments from the fund complex to the market maker and that those payments are compensation to promote or sell the shares of the ETF.

⁷ See Approval Order, supra note 1, at 31-33.

Thus, NYSE Arca has requested, on behalf of itself and those broker-dealers that receive payments under the Incentive Program as discussed in its letter, an exemption from the requirements of Section 11(d)(1) of the Exchange Act and Rule 11d1-2 thereunder.⁸

NYSE Arca maintains that a Broker-Dealer AP and a broker-dealer that is not a Broker-Dealer AP in a particular ETF, but effects transactions in shares of the ETF exclusively in the secondary market (“Non-AP Broker-Dealer”) should be able to rely on the SIA Exemption, notwithstanding the receipt of payments under the Incentive Program. Among other things, the Exchange notes that the LMM Payment is provided only to LMMs that meet or exceed market quality standards and that the Incentive Program will not provide an incentive for LMMs to “push” the securities of participating issuers.⁹ Rather, the Exchange states that the Incentive Program is intended to foster enhanced liquidity, robust quoting activity, narrowed spreads, and reduced transaction costs for investors in participating ETPs. NYSE Arca notes that the LMM Payments are not attributable to LMMs executing transactions in securities, but only for LMMs’

⁸ Letter from Janet McGinness, Senior Vice President and Secretary, NYSE Euronext to David Blass, Chief Counsel, Division of Trading and Markets, Securities and Exchange Commission (September 3, 2013) (“Request Letter”). The relief requested is similar to the relief the Commission previously granted to NASDAQ Stock Market LLC in connection with its pilot Market Quality Program. See Exchange Act Release No. 69892 (June 28, 2013).

⁹ Congress adopted Section 11(d)(1) in response to concerns about potential conflicts of interest faced by persons acting as both brokers and dealers in the distribution of new issue securities. In a House report accompanying the Exchange Act, Congress noted:

It is difficult to serve two masters. And it is particularly difficult to give impartial advice to a client if the dealer-broker has his own securities to sell, particularly when they are new securities for which there is no ready market.

H.R. Rep. No. 1383, 73d Cong., 2d Sess. 15 (1934). Congress concluded that forcing the separation of brokers and dealers would have led brokers to abandon their dealer business, impairing the mechanism to distribute new securities. In lieu of this measure, Congress required broker-dealers to disclose to customers the capacity in which they were acting and adopted section 11(d)(1) prohibiting broker-dealers from extending margin on new issue securities in the distribution of which the broker-dealer had participated. *Id.*

two-sided quoting activity. The Exchange also states that the disclosure provisions of the Incentive Program will alert and educate investors about the program and the LMM Payments.¹⁰

NYSE Arca also asserts that the Incentive Program's goal of enhancing market quality is most likely to be accomplished if the program attracts as many participating market makers as possible. In the Exchange's view, eligible market makers may decline to participate in the program if no exemption from Section 11(d)(1) and Rule 11d1-2 is available, either because the market makers may already extend credit to customers on the securities of participating issuers or because the value to market makers of offering credit services to customers on such securities may outweigh the value of participating in the Incentive Program.¹¹ The Commission recognizes that broker-dealers that have to choose between participating in the Incentive Program and having the ability to offer credit services to customers in reliance on the SIA Exemption for business reasons may determine to continue to offer the credit services and decline to participate in the Incentive Program. In other words, the lack of an available exemption from Section

¹⁰ Request Letter at 7. The Exchange notes that its new rules are designed to provide comprehensive and accessible disclosure to investors about the MQP Program through the Exchange's website or the websites of the participating issuers. New Rules 8.800(b)(6) and (7) require the Exchange to disclose on its website the following information with respect to the operation of the Incentive Program: (i) the ETPs participating in the Incentive Program and the LMM assigned to each participating ETP; (ii) the date a particular ETP begins participating or ceases participating in the Incentive Program; (iii) the date the Exchange receives written notice of an issuer's intent to withdraw its ETP from the Incentive Program, or an LMM's intent to withdraw from its ETP assignment(s) in the Incentive Program, and, in each case, the intended withdrawal date, if provided; and (iv) the amount of the Optional Incentive Fee for each ETP. The Exchange also will include on its website a fair and balanced description of the Incentive Program, including a description of the potential benefits and risks that may be attendant with an ETP's participation in the program. An issuer of an ETP that is approved to participate in the Incentive Program will also be required to (i) issue a press release to the public when an ETP commences or ceases participation in the Incentive Program, (ii) post such press release on its website, and (iii) provide on its website a hyperlink to the Exchange's webpage describing the Incentive Program.

¹¹ Request Letter at 6.

11(d)(1) and Rule 11d1-2 thereunder could serve to reduce the number of market makers in the Incentive Program.

The Commission finds that it is appropriate in the public interest, and is consistent with the protection of investors, to grant a limited exemption from Section 11(d)(1) of the Exchange Act and Rule 11d1-2 thereunder to Broker-Dealer APs and Non-AP Broker-Dealers that participate in the Incentive Program. The Incentive Program is intended to improve market quality by promoting enhanced liquidity, reduced spreads, and reduced cost of investing in the securities of participating issuers. The Commission believes that granting the exemption will encourage a larger number of market makers to participate in the Incentive Program and that a larger number of participating market makers should create greater potential for the market quality improvements the Incentive Program aims to achieve. The Commission notes in particular that the Exchange will determine to pay an LMM Payment only if an LMM maintains certain minimum quoting standards.¹² No portion of the LMM Payment is attributable to sales of ETP securities and thus the LMM Payment should provide no direct incentive for LMMs to promote the sale of ETP securities. Thus, the Commission does not believe that the LMM Payment will provide the kind of incentive for “share-pushing” with which Congress was concerned when it enacted Section 11(d).¹³ Moreover, the required website disclosures, discussed above,¹⁴ should also help LMMs’ customers understand the Program’s effect on LMMs’ incentives and thus will help investors to make informed decisions in light of the additional incentives LMMs may have in providing quotes for these securities.

¹² See note 5, supra.

¹³ See note 9, supra.

¹⁴ See note 10, supra.

Conclusion

IT IS THEREFORE ORDERED, that Broker-Dealer APs and Non-AP Broker-Dealers that participate in the Incentive Program, may rely on the SIA Exemption pertaining to Section 11(d)(1) and Rule 11d1-2 thereunder,¹⁵ subject to the conditions provided in that exemption, notwithstanding that Broker-Dealer APs and Non-AP Broker-Dealers may receive LMM Payments for participating in the Incentive Program as described in your request.

This exemption will expire when the Incentive Program terminates, and is subject to modification or revocation at any time the Commission determines that such action is necessary

¹⁵ See note 4, supra.

or appropriate in furtherance of the purposes of the Exchange Act.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁶

Kevin M. O'Neill
Deputy Secretary

¹⁶ 17 CFR 200.30-3(a)(62).