SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71957; File No. SR-NYSEMKT-2014-06)

April 16, 2014

Self-Regulatory Organizations; NYSE MKT LLC; Order Granting Approval of a Proposed Rule Change Amending Section 17, which are Rules Applicable to Securities known as Fixed Return Options, to Reflect a Name Change to Binary Return Derivatives, a Change to the Calculation of the Settlement Price, Updating Rule References, Adding New Text for ByRDs Series Available for Trading, Amending the Quoting and Trading Increment Applicable to ByRDs, and Adding a New Paragraph 8 to Rule 975NY(a) and Amending Rule 975NY(d)(1) to Address Obvious Errors in ByRDs

I. Introduction

On February 14, 2014, NYSE MKT LLC ("NYSE MKT" or the "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 Section 17 of the NYSE MKT rulebook, which are rules applicable to securities known as Fixed Return Options, to reflect a name change to Binary Return Derivatives ("ByRDs"), a change to the calculation of the settlement price, updating rule references, adding new text for ByRDs series available for trading, amending the quoting and trading increment applicable to ByRDs, and amending Rule 975NY to address obvious and catastrophic errors in ByRDs. The proposed rule change was published for comment in the Federal Register on March 3, 2014.[3] The Commission received no comment letters on the proposal. This order approves the proposed rule change.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 71613 (February 25, 2014), 79 FR 11845 (March 3, 2014) ("Notice").

II. Description of the Proposal

A. ByRDs

NYSE MKT proposes to amend Section 17 of its rulebook, which contains the rules applicable to securities known as Fixed Return Options ("FROs"), to reflect a name change to Binary Return Derivatives ("ByRDs"). On August 14, 2007, the Commission approved the Exchange's proposed rule change to list and trade cash-settled, European-style FROs on individual stocks and exchange-traded funds.[4] FROs are binary options, and differ from other options traded on U.S. options exchanges by providing a discontinuous or non-linear payout.[5] In-the-money FROs pay a fixed sum at expiration regardless of the magnitude of the difference between the options' exercise price and the settlement price. "Finish High" FROs return $100 per contract if the settlement price of the underlying security is above the strike price at expiration, and "Finish Low" FROs return $100 per contract if the settlement price of the underlying security is below the strike price at expiration. Any in-the-money FROs are exercised automatically at expiration.[6]

In March 2009, the Exchange migrated to a new trading system as part of its integration with NYSE Euronext. Because the new trading system was not optimized to accommodate the trading of FROs, the Exchange restricted the opening of new series of FROs and limited transactions to closing only.[7] All open interest in FROs was subsequently either closed or expired and the contracts became dormant.[8] NYSE MKT now proposes to re-launch and rename

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4 See Securities Exchange Act Release No. 56251 (August 14, 2007), 72 FR 46523 (August 20, 2007) ("FROs Approval Order").

5 See FROs Approval Order, supra note 4, at 46523.

6 See FROs Approval Order, supra note 4, at 46523.

7 See Notice, supra note 3, at 11845.

8 See Notice, supra note 3, at 11845.

these securities as ByRDs, which will be available for both electronic and floor trading. With the exception of the proposed rule changes described herein, the rules pertaining to FROs will continue to apply to ByRDs.

B. Renaming and Renumbering of Existing Rules and Clarifying Changes

NYSE MKT proposes to change the title of Section 17 from “Fixed Return Options” to “Binary Return Derivatives”, and replace the terms “Fixed Return Options” or “FROs” in the existing rule text with the terms “Binary Return Derivatives” or “ByRDs.”[9]

The Exchange is proposing to clarify Rule 900FRO, Applicability; Definitions (which is being retitled as “Rule 900ByRDs”),[10] by amending the rule to state that unless specific rules in Section 17 govern, or unless the context otherwise requires, the Rule 900NY series of rules shall be applicable to the trading of ByRDs. This proposed rule change reflects the adoption of the Rule 900NY series of rules, which govern trading of options contracts on the Exchange, and which replaced the rules in place prior to March 2009 that previously governed the trading of FROs. The Exchange is also proposing to amend Rule 901FRO, Fixed Return Options Contracts to be Traded (which is proposed to be retitled as “Rule 901ByRDs”), to state that ByRDs contracts shall be designated as to expiration date (day, month, and year), rather than just expiration month and year. The Exchange also has proposed technical, non-substantive changes to Rule 462(d).10, Minimum Margins, and Rule 904BIN, Position Limits, to update references to Fixed Return Options (FROs) to Binary Return Derivatives (ByRDs).[11]

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9 See Notice, supra note 3, at 11846.

10 The Exchange is proposing to change all references to Fixed Return Options / FROs in the title and text of the Rule 900FRO series to Binary Return Derivatives / ByRDs.

11 See Notice, supra note 3, at 11846.

The Exchange proposes to delete Rule 918FRO, Trading Rotations, Halts and Suspensions, because it contains a reference to Rule 918, which has been deleted from the Exchange's rulebook. Rule 918 has been replaced by the rules in Section 900NY, which are applicable to the trading of ByRDs.[12]

The Exchange also proposes technical changes to Rule 980FRO, Automatic Exercise of Fixed Return Option Contracts (which is proposed to be retitled as "Rule 980ByRDs") to capitalize the defined term "Settlement Price."[13] Additionally, the Exchange is proposing to amend Rule 904FRO, Position Limits, (which is proposed to be retitled as "Rule 904ByRDs") by replacing the term "underlying stock or Exchange-Traded Fund share" with the term "underlying security." This will ensure that Rule 904ByRDs is consistent with Rule 903FRO, Series of FROs Open for Trading (which is proposed to be retitled as "Rule 903ByRDs"), and other rule text, which generally refer to underlying "securities" when discussing options.[14]

C. Series of ByRDs Open for Trading

NYSE MKT proposes to adopt three new paragraphs within Rule 903FRO (which is proposed to be retitled as "Rule 903ByRDs") to specify which series of ByRDs option contracts the Exchange may open for trading and the permissible strike price intervals. Proposed Rule 903ByRDs(a) specifies that, except for consecutive week expiration series, at the commencement of trading on the Exchange for a particular class of ByRDs, the Exchange shall open a minimum of one expiration month for each class of ByRDs open for trading on the Exchange. Proposed Rule 903ByRDs(b) provides that consecutive week expiration series expire at the end of the week, normally a Friday, with consecutive week expirations covering the next

[12] See Notice, supra note 3, at 11847.

[13] See Notice, supra note 3, at 11847.

[14] See Notice, supra note 3, at 11846.

five calendar weeks. New expiration week series will be added for trading on Thursday each week, unless Friday is an Exchange holiday, in which case new expiration series would be added for trading on Wednesday. Proposed Rule 903ByRDs(c) provides that the strike price interval for ByRDs contracts will be $1 for strike prices between $3 and $200, and $5 for strike prices over $200. Proposed Rule 903ByRDs(c) also states that the Exchange will initially list series that are no more than 30% away from the price of the underlying security, and that the Exchange may list additional series if the furthest out of the money strike is less than 10% out of the money. At such time, the Exchange could list additional series that are not more than 30% away from the price of the underlying security.[15]

D. Settlement Price

NYSE MKT proposes to add new Commentary .02 to Rule 910FRO, Determination of the Settlement Price (which is proposed to be retitled as "Rule 910ByRDs"), to provide that the settlement price will be calculated such that it will always round up $.01 in those instances when the settlement price[16] exactly equals an expiring strike price. For example, if the calculated settlement price is $20.00, and there are expiring ByRDs Finish High and Finish Low contracts with a strike price of $20.00, the settlement price will be rounded up to $20.01 so that the Finish High options will pay off. The effect of rounding will be to have long $20.00 strike Finish High holders receiving $100.00 and long $20.00 strike Finish Low holders receiving $0. Under NYSE MKT's current rules, it is possible for an investor to hold a position that appears to guarantee a pay off at $100.00 at expiration, but that instead pays $0. For example, if an investor holds both

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15 See Notice, supra note 3, at 11846.

16 NYSE MKT calculates settlement price based upon an all-day volume weighted average price that is based on trading in the underlying security on the last trading day prior to expiration. NYSE MKT uses composite prices during regular trading hours as reported by industry price vendors. See Rule 900FRO / proposed Rule 900ByRDs(b)(4)-(5); see also FROs Approval Order, supra note 4, at 46523.

a $20.00 strike Finish High contract and a $20.00 strike Finish Low contract, the investor would receive $0 if the settlement price was calculated to exactly equal the $20.00 strike price. The proposed rule change will avoid a situation where neither the Finish High nor the Finish Low ByRDs contract pays off at expiration.[17]

E. Underlying Securities

NYSE MKT proposes to amend Commentary .02 to Rule 915FRO, Criteria for Underlying Securities (which is proposed to be retitled as "Rule 915ByRDs"), to include Section 107 securities[18] as eligible underlying securities upon which ByRDs contracts may be listed. The Exchange also proposes to amend Commentary .03 to Rule 916FRO, Withdrawal of Approval of Underlying Securities (which is proposed to be retitled as "Rule 916ByRDs"), which describes the criteria necessary for the continued approval to introduce new series of ByRDs for trading, to include Section 107 Securities.

F. Minimum Price Variations

In approving the trading and listing of FROs, the Commission approved a minimum price variation ("MPV") for FROs in classes not included in the Penny Quoting Pilot Program of $0.05, and $0.01 for classes in the Penny Quoting Pilot Program.[19] The Exchange now proposes to amend Rule 951FRO, Premium Bids and Offers (which is proposed to be retitled as "Rule 951ByRDs"), to state that the MPV for quoting and trading of ByRDs contracts will be $0.01 for

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[17] See Notice, supra note 3, at 11846-47.

[18] Section 107 Securities include Index-Linked Securities, Commodity-Linked Securities, Currency-Linked Securities, Fixed Income-Linked Securities, Futures-Linked Securities, and Combination-Linked Securities. See NYSE MKT Rule 915, Commentary .11.

[19] See FROs Approval Order, supra note 4, at 45624.

all series. NYSE MKT is also proposing to delete an obsolete rule reference in proposed Rule 951ByRDs to NYSE MKT Rule 951.[20]

G. Bid-Ask Differentials

NYSE MKT is not proposing to change market makers' quoting obligations for ByRDs; however, the Exchange is proposing to delete a provision in Rule 958FRO, Maximum Bid-Ask Differentials (which is proposed to be retitled as "Rule 958ByRDs"), that provides that in the event the bid-ask differential in the underlying security is greater than the bid-ask differential described in Rule 958FRO,[21] the permissible price differential for any in-the-money series may be identical to that in the underlying security market.[22] In addition, the Exchange proposes to delete an obsolete reference in proposed Rule 958ByRDs to Rule 958.

H. Obvious Errors and Catastrophic Errors

NYSE MKT proposes to revise Rule 975NY, Obvious Errors and Catastrophic Errors, to include a new subsection (a)(8) that addresses the handling of transactions in ByRDs option contracts that are subject to the Obvious Error provisions of Rule 975NY. Proposed Rule 975NY(a)(8) provides that any transaction in a ByRDs contract that is higher or lower than the Theoretical Price by $0.25 or more shall be deemed an obvious error, subject to the adjustment procedures of Rule 975NY(a)(3), unless such adjustment would result in a price higher than

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20 See Notice, supra note 3, at 11847.

21 Rule 958FRO / proposed Rule 958ByRDs provides that a market maker must bid and offer so as to create differences of no more than $0.25 between the bid and offer for each ByRDs contract except during the business day of the expiration, or, in the case of an option contract expiring on a day that is not a business day, during the business day prior to expiration where the maximum permissible price differential for ByRDs may be $0.50. See Rule 958FRO / proposed Rule 958ByRDs.

22 See Notice, supra note 3, at 11847.

$1.02, in which case the adjustment price shall be $1.02.[23] The Exchange also proposes to amend Rule 975NY(a)(1) to add a reference to proposed paragraph (a)(8).

The Exchange also proposes to amend paragraph (d)(1) of Rule 975NY to state that transactions in ByRDs contracts over $1.02 shall qualify as catastrophic errors if participants request a review under the existing provisions of paragraph (d)(3)(A). Transactions in ByRDs contracts that qualify as catastrophic errors will be adjusted in accordance with the procedures of proposed subsection (i) of paragraph (d)(3)(C), which states that any catastrophic error in ByRDs contracts will result in an adjustment to $1.02 unless the parties mutually agree to nullify the transaction or agree to a different adjustment price.[24]

III. Discussion and Commission Findings

After careful consideration of the proposal, 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,[25] and, in particular, the requirements of Section 6 of the Act.[26] Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[27] which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest. The Commission believes that allowing the Exchange to relaunch FROs for listing and trading as ByRDs may provide investors with a useful investment

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23 See Notice, supra note 3, at 11847.

24 See Notice, supra note 3, at 11847.

25 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).

26 15 U.S.C. 78f.

27 15 U.S.C. 78f(b)(5).

choice. The proposal should ensure that these binary options would continue to receive the benefits of trading on an exchange, which include: a centralized forum for price discovery; pre- and post-trade transparency; standardized contract specifications; and the guarantee of the Options Clearing Corporation ("OCC").

The Commission believes that replacing the references in Section 17 of NYSE MKT's rules to Fixed Return Options and/or FROs to Binary Return Derivatives and/or ByRDs may remove impediments to and perfect the mechanism of a free and open market by making the rule text consistent with the new name of the options product. The Commission also believes that the proposed clarifying changes and the deletions of obsolete rule references may reduce potential investor confusion, and protect investors and the public interest.

The Commission believes that permitting the Exchange to list and trade consecutive week expiration series may provide market participants an investment vehicle that may be more useful for short-term strategies than cycle month series. In addition, the Commission believes that the proposal to include additional eligible underlying securities upon which ByRDs contracts may be listed, the proposed strike price intervals, and the MPV for quoting and trading all ByRDs contracts series are reasonable and consistent with the Act.

The Commission believes that the proposal to calculate the settlement price to always round up $0.01 in instances when the settlement price exactly equals an expiring ByRDs option strike price is reasonable and may perfect the mechanism of a free and open market. In addition, the proposed change may protect investors and reduce potential confusion by providing certainty that either the Finish High or Finish Low ByRDs option contracts will pay off at expiration.

The Commission believes that the proposed changes to the obvious and catastrophic error rule, Rule 975NY, are consistent with the Act as they would protect investors and the public interest by providing certainty about how obvious and catastrophic errors in ByRDs would be treated. The Commission notes that the new provisions in the obvious and catastrophic error rule describe how to determine whether transactions in ByRDs contracts should be treated as errors, and if so, how they should be adjusted and the maximum adjustment price for such errors. The new provisions still require that the transactions be erroneous, as provided in Rule 975NY, and set forth specific criteria and procedures for the handling of such errors. The Commission emphasizes the importance of specific and objective criteria to determine how and when to adjust transactions involving obvious or catastrophic errors to provide certainty to market participants and to reduce confusion. Therefore, the Commission believes that the proposed changes to Rule 975NY are appropriate.

In approving this proposal, the Commission has relied on the following representations made by NYSE MKT: (i) the Exchange systems have the functionality to support the trading of ByRDs; (ii) the Exchange and the Options Price Reporting Authority ("OPRA") have the necessary systems capacity to handle additional traffic associated with the re-listing and trading of ByRDs contracts; (iii) the Exchange has discussed the proposed listing and trading of ByRDs contracts with the OCC, which has represented that it is able to accommodate the clearing and settlement of ByRDs contracts; and (iv) the Exchange will monitor any increased trading volume associated with the listing of new series of ByRDs and will analyze the effect, if any, that the additional volume has on the capacity of the Exchange's, OPRA's, and the OCC's automated systems.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[28] that the proposed rule change (SR-NYSEMKT-2014-06), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[29]

Kevin M. O'Neill
Deputy Secretary

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28 15 U.S.C. 78s(b)(2).

29 17 CFR 200.30-3(a)(12).