SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-78888; File Nos. SR-NYSEARCA-2016-109; SR-NYSEMKT-2016-73)

September 20, 2016

Self-Regulatory Organizations; NYSE Arca, Inc.; NYSE MKT LLC; Order Approving Proposed Rule Changes to Provide for the Rejection of Certain Electronic Complex Orders

I. Introduction

On August 3, 2016, NYSE Arca, Inc. ("NYSE Arca") and NYSE MKT LLC ("NYSE MKT") (each an "Exchange" and, together, the "Exchanges") filed with the Securities and Exchange Commission (the "Commission"), pursuant to Section 19(b)(1)[1] of the Securities Exchange Act of 1934 (the "Act"),[2] and Rule 19b-4 thereunder,[3] proposed rule changes to amend NYSE Arca Rule 6.91(b) and NYSE MKT Rule 980(d), respectively, to allow the Exchanges to reject certain Electronic Complex Orders.[4] The proposed rule changes were published for comment in the in the Federal Register on August 17, 2016.[5] The Commission received no comments regarding the proposals. This order approves the proposed rule changes.

II. Description of the Proposals

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

2 15 U.S.C. 78a.

3 17 CFR 240.19b-4.

4 NYSE Arca Rule 6.91 defines "Electronic Complex Order" to mean, for purposes of that rule, "any Complex Order as defined in Rule 6.62(e) or any Stock/Option Order or Stock/Complex Order as defined in Rule 6.62(h) that is entered into the NYSE Arca System." NYSE MKT Rule 980 defines "Electronic Complex Order" to mean, for purposes of that rule, "any Complex Order as defined in Rule 900.3NY(e) that is entered into the System."

5 See Securities Exchange Act Release Nos. 78546 (August 11, 2016), 81 FR 54867 ("NYSE Arca Notice"); and 78544 (August 11, 2016), 81 FR 54893 ("NYSE MKT Notice").

NYSE Arca and NYSE MKT each require market makers to use risk limitation mechanisms that automatically remove a market maker's quotes in all series of an options class when the market maker's risk settings are triggered.[6] The Exchanges state that the risk settings are designed to mitigate the risk of multiple executions against a market maker's quotes occurring simultaneously across multiple series and multiple options classes.[7] According to the Exchanges, the risk settings allow market makers to provide liquidity across potentially thousands of options series without being at risk of executing the full cumulative size of all of their quotes before being given adequate opportunity to adjust their quotes.[8]

An Electronic Complex Order may execute against quotes or individual orders comprising the Complex Order (the "leg markets"), or against Electronic Complex Orders resting in the Consolidated Book.[9] An incoming Electronic Complex Order will execute against customer interest in the leg markets before executing against resting Electronic Complex Orders at the same price (i.e., at the same total net debit or credit), provided that the leg market interest

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6 See NYSE Arca Notice, 81 FR at 54868; and NYSE MKT Notice, 81 FR at 54893. Pursuant to NYSE Arca Rule 6.40(b)(3), (c)(3), and (d)(3), and NYSE MKT Rule 928(b)(3), (c)(3), and (d)(3), the Exchanges establish a time period during which their respective Systems calculate: (1) the number of trades executed by a market maker in a specified options class; (2) the volume of contracts executed by a market maker in a specified options class; or (3) the percentage of a market maker's quoted size in specified options class (the "risk settings"). When a market maker has breached its risk settings (i.e., has traded more than the contract or volume limit or cumulative percentage limit of a class during the specified measurement interval), each Exchange's System cancels all of the market maker's quotes in that class until the market maker notifies the Exchange that it will resume submitting quotes. See id. See also NYSE Arca Rule 6.40, Commentary .02; and NYSE MKT Rule 980NY, Commentary .02.

7 See NYSE Arca Notice, 81 FR at 54868; and NYSE MKT Notice, 81 FR at 54894.

8 See id.

9 See id. See also NYSE Arca Rule 6.91(a)(2)(ii); and NYSE MKT Rule 980NY(c)(ii).

can execute the Electronic Complex Order in full or in a permissible ratio.[10] When an Electronic Complex Order executes against leg market interest, the execution of the individual legs is processed as a single transaction package, not as a series of individual transactions, because the execution of each leg of the Electronic Complex Order is contingent on the execution of the other legs of the order.[11] Because the market maker risk settings are calculated after the execution of all of the legs of the transaction, rather than after the execution of each individual leg of the transaction, an Electronic Complex Order that executes against leg market interest may execute before triggering a market maker's risk settings, essentially bypassing the risk settings.[12] The Exchanges note that if the same legs were sent as individual orders, rather than as components of a complex order, the risk settings might be triggered.[13]

According to the Exchanges, Electronic Complex Order where two or more legs are buying (selling) calls (puts) raise particular concerns because these "directional" complex orders are aggressively buying or selling volatility.[14] The Exchanges state that they have seen a recent increase in the use of directional complex orders as a way to trade against multiple series on the same side of the market without triggering Market Maker risk settings, thereby undermining the purpose of the risk settings.[15] To address this concern, the Exchanges propose to adopt NYSE

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[10] See id.

[11] See NYSE Arca Notice, 81 FR at 54868; and NYSE MKT Notice, 81 FR at 54894.

[12] See id.

[13] See id.

[14] See id. The Exchanges note that the majority of electronic complex orders are calendar and vertical spreads, butterflies and straddles, which are designed to hedge a potential move of the underlying security or to capture premium from an anticipated market event. See id.

[15] See id.

Arca Rule 6.91(b)(4) and NYSE MKT Rule 980NY(d)(4), which provide that an Electronic Complex Order will be rejected if it is:

(i) composed of two legs that are (a) both buy orders or both sell orders, and (b) both legs are calls or both legs are puts;[16] or

(ii) composed of three or more legs and (a) all legs are buy orders; or (b) all legs are sell orders.[17]

The Exchanges believe that the potential risk of the specified directional Electronic Complex Orders undermining the efficacy of market makers' risk settings outweighs any potential benefit to market participants submitting such orders packaged as Electronic Complex Orders.[18] The Exchanges also believe that the proposal will help to eliminate a degree of unnecessary risk borne by market makers when fulfilling their quoting obligations and encourage them to provide tighter and deeper markets, to the benefit of all market participants.[19] The Exchanges note that market participants will continue to be able to enter each leg of these directional complex orders as separate orders.[20] The Exchanges state that other exchanges have adopted rules designed to prevent complex orders from effectively bypassing market maker risk

16 The Exchanges states that the following types of orders would be rejected under NYSE Arca Rule 6.91(b)(4)(i) and NYSE MKT Rule 980NY(d)(4)(i): Buy Call 1, Buy Call 2; Sell Call 1, Sell Call 2; Buy Put 1, Buy Put 2; and Sell Put 1, Sell Put 2. See NYSE Arca Notice, 81 FR at 54869; and NYSE MKT Notice, 81 FR at 54894.

17 The Exchanges state that the following types of orders would be rejected under NYSE Arca Rule 6.91(b)(4)(ii) and NYSE MKT Rule 980NY(d)(4)(ii): Buy Call 1, Buy Call 2, Buy Put 1; Buy Put 1, Buy Put 2, Buy Put 3; Buy Call 1, Buy Call 2, Buy Call 3; Buy Put 1, Buy Put 2, Buy Call 3; and Sell Put 1, Sell Put 2, Sell Call 1. See id.

18 See NYSE Arca Notice, 81 FR at 54869; and NYSE MKT Notice, 81 FR at 54894.

19 See NYSE Arca Notice, 81 FR at 54869; and NYSE MKT Notice, 81 FR at 54895.

20 See id.

parameters.[21] Because of the non-traditional nature of directional complex orders, the Exchanges believe that it is unlikely that directional complex orders would execute against complex order interest.[22] Accordingly, the Exchanges believe that rejecting directional Electronic Complex Orders outright, rather than simply preventing them from executing against leg market interest, would have the same practical impact for order sending firms and would be the most effective and transparent means of handling these orders.[23] The Exchanges also believe that rejecting, and therefore preventing the execution of, directional Electronic Complex Orders provides clarity with respect to the disposition of the orders and assures that the market maker risk settings will operate as intended.[24]

Finally, the Exchanges propose to delete the words "Types of" from NYSE Arca Rule 6.91(b) and NYSE MKT Rule 980NY(d) because the subsequent paragraphs in the rules describe certain requirements for Electronic Complex Orders, rather than types of Electronic Complex Orders.[25]

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21 See NYSE Arca Notice, 81 FR at 54869; NYSE MKT Notice, 81 FR at 54894. See also CBOE Rule 6.53C(d)(ii)(A)(2)(B) and ISE Rule 722(b)(3)(ii)(A) and (B) and Securities Exchange Act Release Nos. 73023 (September 9, 2014), 79 FR 55033 (order approving File No. SR-ISE-2014-10); 72986 (September 4, 2010), 79 FR 53798 (September 10, 2014) (order approving File No. SR-CBOE-2014-017); 77297 (March 4, 2016), 81 FR 12764 (March 10, 2016) (notice of filing and immediate effectiveness of File No. SR-CBOE-2016-014); and 76106 (October 8, 2015), 80 FR 62125 (October 15, 2015) (notice of filing and immediate effectiveness of File No. SR-CBOE-2014-081). The Exchanges acknowledge that CBOE and ISE do not reject the complex orders identified as presenting a risk to market makers. See NYSE Arca Notice, 81 FR at 54869; NYSE MKT Notice, 81 FR at 54894.

22 See NYSE Arca Notice, 81 FR at 54869; and NYSE MKT Notice, 81 FR at 54895.

23 See id.

24 See id.

25 See NYSE Arca Notice, 81 FR at 54868; and NYSE MKT Notice, 81 FR at 54894.

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule changes are consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.[26] In particular, the Commission finds that the proposed rule changes are 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 prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, 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 proposals are designed to prevent the Electronic Complex Orders specified in NYSE Arca Rule 6.91(b)(4) and NYSE MKT Rule 980NY(d)(4) from undermining the efficacy of market makers' risk settings. The Exchanges believe that preserving the efficacy of market makers' risk settings could reduce risks to market makers, thereby encouraging them to provide additional liquidity and narrower quote spreads.[28] The Commission notes that other options exchanges have adopted similar rules.[29] In addition, the Commission notes that market participants will be able to submit the individual component legs of the orders specified in NYSE Arca Rule 6.91(b)(4) and NYSE MKT Rule 980NY(d)(4) as separate orders for execution against leg market interest. Finally, the Commission believes that the deletion from NYSE Arca Rule 6.91(b) and NYSE MKT Rule 980NY(d) of references to "Types of"

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26 In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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

28 See NYSE Arca Notice, 81 FR at 54869; NYSE MKT Notice, 81 FR at 54895.

29 See CBOE Rule 6.53C(d)(ii)(A)(2)(B) and ISE Rule 722(b)(3)(ii)(A) and (B). However, as noted above, CBOE and ISE do not reject the orders identified as presenting a risk to market makers.

Electronic Complex Orders will help to assure that the Exchanges' rules clearly present the requirements applicable to Electronic Complex Orders.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[30] that the proposed rule changes (File Nos. SR-NYSEARCA-2016-109 and SR-NYSEMKT-2016-73) are approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[31]

Robert W. Errett
Deputy Secretary

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[30] 15 U.S.C. 78s(b)(2).

[31] 17 CFR 200.30-3(a)(12).