

SECURITIES AND EXCHANGE COMMISSION

Release No. 34-69707

June 6, 2013

Order Granting a Limited Exemption from Rule 102 of Regulation M Concerning the NYSE Arca, Inc.'s Exchange Traded Product Incentive Program Pilot Pursuant to Regulation M Rule 102(e)

The Securities and Exchange Commission ("Commission") approved a proposed rule change of the NYSE Arca, Inc. ("Exchange" or "NYSE Arca") to add new NYSE Arca Equities Rule 8.800 ("New Rule 8.800") which establishes the exchange-traded product ("ETP") Incentive Program ("Incentive Program" or "Program") effective on one year on a pilot basis. The Incentive Program is designed to incentivize market makers to take Lead Market Maker ("LMM") assignments in certain lower volume ETPs by offering an alternative fee structure for such LMMs that would be funded from the Exchange's general revenues. The costs of the Incentive Program would be funded by charging participating issuers (which may be paid by sponsors on behalf of the issuer) non-refundable "Optional Incentive Fees," which would be credited to LMMs from the Exchange's general revenues.¹ The Commission believes that

¹ See Securities Exchange Act Release No. 69706 (June 6, 2013) ("Approval Order"). The Approval Order contains a detailed description of the 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.

Previously, the Exchange filed, but later withdrew, an initial proposed rule change to establish the Program. On April 27, 2012, NYSE Arca filed with the Commission, pursuant to Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder, a proposed rule change to establish the Program. The proposed rule change was published for comment in the Federal Register on May 17, 2012. Securities Exchange Act Release No.

payment of the Optional Incentive Fee by the issuer (or a sponsor on behalf of the issuer) for the purpose of incentivizing market makers to become LMMs in the issuer's securities would constitute an indirect attempt by the issuer to induce a bid for or a purchase of a covered security during a restricted period.² As a result, absent exemptive relief, participation in the Incentive Program by an issuer (or sponsor on behalf of the issuer) would violate Rule 102 of Regulation M.³ This order grants a limited exemption from Rule 102 of Regulation M solely to permit issuers and sponsors to participate in the Program during the pilot, subject to certain conditions described below.

NYSE Arca stated that the Incentive Program is designed to incentivize market makers to undertake LMM assignments in ETPs.⁴ An issuer of an ETP that participates in the Incentive

66966 (May 11, 2012), 77 FR 29419 (May 17, 2012). On June 20, 2012, the Commission extended the time period in which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change to August 15, 2012. Securities Exchange Act Release No. 67222 (June 20, 2012), 77 FR 38116 (June 26, 2012). On July 11, 2012, the Commission instituted proceedings to determine whether to approve or disapprove the proposed rule change. Securities Exchange Act Release No. 67411 (July 11, 2012), 77 FR 42052 (July 17, 2012). On October 2, 2012, the Commission issued a notice of designation of a longer period for Commission action on proceedings to determine whether to disapprove the proposed rule change. Securities Exchange Act Release No. 67962 (Oct. 2, 2012), 77 FR 61462 (Oct. 9, 2012). On January 9, 2013, the Exchange withdrew the proposed rule change. Securities Exchange Release No. 68616 (Jan. 10, 2013), 78 FR 3482 (Jan. 16, 2013).

² See Securities Exchange Act Release No. 67411 (July 11, 2012), 77 FR 42052 (July 17, 2012) (stating “[t]he Commission believes that issuer payments made under the SRO Proposals would constitute an indirect attempt by the issuer of a covered security to induce a purchase or bid in a covered security during a restricted period in violation of Rule 102... [u]nder the NYSE Arca Proposal, the purpose of the Program is ‘to create a Incentive Program for issuers of certain ETPs listed’ on NYSE Arca, which... could induce bids or purchases for the issuer’s security during a restricted period”).

³ 17 CFR 242.102.

⁴ See Approval Order.

Program would elect to pay an “Optional Incentive Fee” to NYSE Arca in an amount ranging from \$10,000 to \$40,000 per year with the actual amount to be determined by the issuer.⁵ The Optional Incentive Fee is in addition to the currently applicable listing and annual fees applicable to the ETP and is paid by the issuer to the Exchange’s general revenues.⁶ Subject to the requirements set forth in New Rule 8.800, a market maker accepting an LMM assignment in an ETP in the Incentive Program would receive a payment quarterly from NYSE Arca (“LMM Payment”) in an amount equal to the Optional Incentive Fee, less a 5% NYSE Arca administration fee.⁷ If the LMM does not meet or exceed its Incentive Program performance standards for an assigned ETP for a particular month or if the ETP is withdrawn from the Program pursuant to the rule, the LMM would not receive a LMM Payment for that month.⁸ The voluntary Program established by New Rule 8.800 will be effective for one year on a pilot basis.⁹

Under New Rule 8.800, NYSE Arca will be required to provide notification on its website regarding: (i) the ETPs participating in the Incentive Program, (ii) the date a particular ETP begins 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, and the intended withdrawal date, if provided, (iv) the date a particular ETP ceases participating in the Incentive

⁵ Id.

⁶ Id. Under the current fee schedule for listings, an issuer of an ETP is required to pay a listing fee that ranges from \$5,000 to \$45,000. ETP issuers also pay a graduated annual fee based on the number of shares of the ETP that are outstanding, which ranges \$5,000 to \$55,000. See Securities Exchange Act Release No. 67411 (July 11, 2012), 77 FR 42052 (July 17, 2012).

⁷ Approval Order.

⁸ Id.

⁹ Preamble to New Rule 8.800.

Program, (v) the LMM assigned to each ETP participating in the Incentive Program, (vi) the date the Exchange receives written notice of an LMM's intent to withdraw from its ETP assignment(s) in the Incentive Program, and the intended withdrawal date, if provided, and (vii) the amount of the Optional Incentive Fee for each ETP.¹⁰ This page would also include a fair and balanced description of the Incentive Program, including (i) a description of the Incentive Program's operation as a pilot, including the effective date thereof, (ii) the potential benefits that may be realized by an ETP's participation in the Incentive Program, (iii) the potential risks that may be attendant with an ETP's participation in the Incentive Program, (iv) the potential impact resulting from an ETP's entry into and exit from the Incentive Program, and (v) how interested parties can request additional information regarding the Incentive Program and/or the ETPs participating therein.¹¹ Furthermore, an issuer that is approved to participate in the Incentive Program shall issue a press release to the public, in a form and manner prescribed by the Exchange, when it commences participation or ceases to participate in the Incentive Program.¹² Such press release would be issued, if practicable, at least two days before the ETP commences or ceases participation in the Incentive Program.¹³ The issuer also will be required to dedicate space on its website, or, if it does not have a website, on the website of the adviser or sponsor of the ETP, to (i) include any such press releases and (ii) provide a hyperlink to the dedicated page on NYSE Arca's website that describes the Program.¹⁴

¹⁰ New Rule 8.800(b)(6).

¹¹ Id.

¹² New Rule 8.800(b)(7).

¹³ Id.

¹⁴ Id.

The Approval Order notes commenters' general support of the Program's stated goal to increase liquidity and promote efficient robust markets for ETPs.¹⁵ However, certain commenters expressed concerns about the Program as originally proposed last year,¹⁶ including the departure from rules precluding market makers from directly or indirectly accepting payment from an issuer of a security for acting as a market maker.¹⁷ In particular, commenters to that proposal discussed the potential distortive impact on the natural market forces of supply and

¹⁵ See Approval Order Section II.

¹⁶ See note 1, supra. Only two comments were received when the proposal was re-filed with the Commission, both of which were in favor of the proposal. See Letter from John Hyland, CFA, Chief Investment Officer, United States Commodity Funds, dated April 10, 2013 and Letter from Stanislav Dolgoplov, Assistant Adjunct Professor and Lowell Milken Institute Law Teaching Fellow, University of California, Los Angeles, dated April 26, 2013. The Commission believes, however, that the concerns raised by commenters regarding the original proposal still are relevant to the proposal as re-filed with the Commission.

¹⁷ See, e.g., Letter from Gus Sauter, Managing Director and Chief Investment Officer, Vanguard, dated June 7, 2012 (citing to his comment letter regarding the similar NASDAQ Market Quality Program that included a discussion of NASD Notice to Members 75-16 regarding the reasons for prohibiting issuer payments for market making: "The additional factor of payments by an issuer to a market maker would probably be viewed as a conflict of interest since it would undoubtedly influence, to some degree, a firm's decision to make a market and thereafter, perhaps, the prices it would quote. Hence, what might appear to be independent trading activity may well be illusory."). In addition, another commenter noted "that market maker incentive programs, such as the [then-proposed Program], represent a departure from the current rules precluding market makers from accepting payment from an issuer of a security for acting as a market marker" yet supported the concept of market maker incentive programs on a pilot basis. Letter from Ari Burstein, Investment Company Institute ("ICI"), dated June 7, 2012. In a subsequent letter, however, the same commenter noted that certain of its members opposed the Program as originally proposed and stated that it "could create a 'pay-to-play' environment." Letter from Ari Burstein, ICI, dated Aug. 16, 2012. The Approval Order also notes that a number of aspects of the Program mitigate the concerns that the rule in question, FINRA Rule 5250 (Payments for Market Making), were designed to address.

demand.¹⁸ Commenters also discussed what they viewed as the failure of the originally-proposed Program requirements to adequately mitigate potential negative impacts of that proposal.¹⁹

One commenter stated that “[i]ssuer payments to market makers have the potential to distort market forces, resulting in spreads and prices that do not reflect actual supply and demand.”²⁰ One commenter questioned whether any safeguards could alleviate their concerns regarding issuer payments to market makers.²¹ Another commenter questioned whether information relating to the similar NASDAQ Market Quality Program posted to that exchange’s website in a similar manner as required in New Rule 8.800(b)(6) by NYSE Arca would adequately address investor protection and market integrity concerns because investors may not search an exchange website for important information about a particular ETP.²²

¹⁸ See, e.g., Letter from F. William McNabb, Chairman and Chief Executive Officer, Vanguard, dated Aug. 16, 2012.

¹⁹ See, e.g., Letter from Gus Sauter, Managing Director and Chief Investment Officer, Vanguard, dated June 7, 2012.

²⁰ Letter from F. William McNabb, Chairman and Chief Executive Officer, Vanguard, dated Aug. 16, 2012.

²¹ Letter from Ari Burstein, ICI, dated Aug. 16, 2012 (stating “ICI members who oppose the Programs believe any fixes to the proposed parameters will be insufficient to address their overall concerns with market maker incentive programs”).

²² Letter from Gus Sauter, Managing Director and Chief Investment Officer, Vanguard, dated (May 3, 2012) (asking “[f]or example, given what we know about investor behavior, is it likely that investors would consult Nasdaq’s website for information about which ETFs and market makers are participating in the [NASDAQ Market Quality Program]... [i]f not, then most investors would not be able to distinguish quotations that reflect true market forces from quotations that have been influenced by issuer payments”).

Rule 102 of Regulation M

Rule 102 of Regulation M prohibits issuers, selling security holders, or any affiliated purchaser of such persons, directly or indirectly, from bidding for, purchasing, or attempting to induce any person to bid for or purchase a covered security²³ during the applicable restricted period in connection with a distribution of securities effected by or on behalf of an issuer or selling security holder, except as specifically permitted in the rule.²⁴ As mentioned above, the Commission believes that the payment of the Optional Incentive Fee would constitute an indirect attempt to induce a bid for or purchase of a covered security during the applicable restricted period.²⁵ As a result, absent exemptive relief, participation in the Program by a sponsor or issuer would violate Rule 102.

On the basis of the conditions set out below and the requirements set forth in New Rule 8.800, which in general are designed to help inform investors about the potential impact of the 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 Rule 102 of Regulation M solely to permit the payment of the Optional Incentive Fee as set forth in New Rule 8.800 during the pilot.²⁶ This limited exemption is conditioned on a requirement that the security participating in

²³ Covered security is defined as any security that is the subject of a distribution, or any reference security. 17 CFR 242.100(b).

²⁴ 17 CFR 242.102(a).

²⁵ See note 2, *supra*.

²⁶ Rule 102(e) allows the Commission to grant an exemption from the provision of Rule 102, either unconditionally or on specified terms and conditions, to any transaction or class of transactions, or to any security or class of securities.

the Program is an ETP and the secondary market price for shares of the ETP must not vary substantially from the net asset value of such ETP shares during the duration of the ETP's participation in the Program. This condition is designed to limit the Program to ETPs that have a pricing mechanism that is expected to keep the price of the ETP shares tracking the net asset value of the ETP shares, which should make the shares less susceptible to price manipulation.

This limited exemption is further conditioned on disclosure requirements, as set forth below, which are designed to alert potential investors that the trading market for the otherwise less liquid securities in the Program may be affected by participation in the Program. By making it easier for investors to be able to distinguish which quotations may have been influenced by the Optional Incentive Fee from those that have not, and by requiring the issuers and sponsors to provide information on the potential effect of Program participation on the price and liquidity of a security participating in the Program, the required enhanced disclosure requirements are designed to inform potential investors about the potential distortive impact of the Optional Incentive Fee on the natural market forces of supply and demand. The general disclosures required by New Rule 8.800, while helpful, may not be sufficient to obtain this result.²⁷ The required enhanced disclosures are expected to promote greater investor protection by helping to

²⁷ New Rule 8.800(b)(7) does not contain any specific content requirements for issuer or sponsor disclosure, other than a "press release" when entering or leaving the Program and a hyperlink on a dedicated issuer, advisor, or sponsor's webpage to the Exchange's website that contains a number of specific disclosures about the program. As outlined below, the enhanced disclosures required of the issuer or sponsor as conditions to this order require that the issuer or sponsor's press release and webpage directly contain a number of helpful disclosures for investors, including risks of the program.

ensure that investors will have easier access to important information about a particular ETP.²⁸

As a practical matter, these requirements are not intended to be duplicative with the issuer disclosures required by New Rule 8.800. These requirements can be satisfied via the press release and dedicated webpage required by New Rule 8.800(b)(7), however these materials must contain all the required disclosures outlined below, and be in the manner stated in the condition, in addition to any requirements of the Exchange. Issuers or sponsors of products that are not registered under the Investment Company Act of 1940, as amended, (“1940 Act”) may also meet the press release requirements of these enhanced disclosures in a manner compliant with Regulation FD (other than website only disclosure).²⁹ We also note that, to the extent that information about participation in the Program is material, disclosure of this kind may already be required by the federal securities laws and rules.

Conclusion

IT IS THEREFORE ORDERED, that issuers or sponsors who pay an Optional Incentive Fee are hereby exempted from Rule 102 of Regulation M solely to permit the payment of the Optional Incentive Fee as set forth in New Rule 8.800 in connection with a security participating in the Program during the pilot, subject to the conditions contained in this order and compliance with the requirements of New Rule 8.800.

This exemption is subject to the following conditions:

²⁸ The required website and press release disclosures should be less burdensome than other methods of notifying investors of a security’s participation in the Program, such as requiring a ticker symbol identifier or flagging participating LMM quotes and trades.

²⁹ See condition (4), infra.

1. The security participating in the Program is an ETP and the secondary market price for shares of the ETP must not vary substantially from the net asset value of such ETP shares during the duration of the security's participation in the Program;
2. The issuer of the participating ETP, or sponsor on behalf of the issuer, must provide prompt notice to the public by broadly disseminating a press release prior to entry (or upon re-entry) into the Program. This press release must disclose:
 - a. The payment of an Optional Incentive Fee is intended to generate more quotes and trading than might otherwise exist absent this payment, and that the security leaving the Program may adversely impact a purchaser's subsequent sale of the security; and
 - b. A hyperlink to the webpage described in condition (5) below;
3. The issuer of the participating ETP, or sponsor on behalf of the issuer, must provide prompt notice to the public by broadly disseminating a press release prior to a security leaving the Program for any reason, including termination of the Program. This press release must disclose:
 - a. The date that the security is leaving the Program and that leaving the Program may have a negative impact on the price and liquidity of the security which could adversely impact a purchaser's subsequent sale of the security; and
 - b. A hyperlink to the webpage described in condition (5) below;
4. In place of the press releases required by conditions (2) and (3) above, an issuer of a participating ETP that is not registered under the 1940 Act, or sponsor on behalf of the issuer, may provide prompt notice to the public through the use of such other written Regulation FD compliant methods (other than website disclosure only) that is

- designed to provide broad public dissemination as provided in 17 CFR 243.101(e) provided, however, that such other methods must contain all the information required to be disclosed by conditions (2) and (3) above;
5. The issuer of the participating ETP, or sponsor on behalf of the issuer, must provide prompt, prominent and continuous disclosure on its website in the location generally used to communicate information to investors about a particular security participating in the Program, and for a security that has a separate website, the security's website of:
 - a. The security participating in the Program and ticker, date of entry into the Program, and the amount of the Optional Incentive Fee;
 - b. Risk factors investors should consider when making an investment decision, including that participation in the Program may have potential impacts on the price and liquidity of the security; and
 - c. Termination date of the pilot, anticipated date (if any) of the security leaving the Program for any reason, date of actual exit (if applicable), and that the security leaving the Program could adversely impact a purchaser's subsequent sale of the security; and
 6. The website disclosure in condition (5) above must be promptly updated if a material change occurs with respect to any information contained in the disclosure.

This exemptive relief expires when the pilot terminates, and is subject to modification or revocation at any time the Commission determines that such action is necessary or appropriate in furtherance of the purposes of the Exchange Act. This exemptive relief is limited solely to the payment of the Optional Incentive Fee as set forth in New Rule 8.800 for a security that is an

ETP participating in the Program,³⁰ and does not extend to any other activities, any other security of the trust related to the participating ETP, or any other issuers.³¹ In addition, persons relying on this exemption are directed to the anti-fraud and anti-manipulation provisions of the Exchange Act, particularly Sections 9(a) and 10(b), and Rule 10b-5 thereunder. Responsibility

³⁰ All ETPs that are allowed to participate in the Program have a pool of underlying assets. See New Rule 8.800(a)(2). Should the program be modified to include other ETPs, such as exchange-traded notes, that do not have a pool of underlying assets, the Commission would consider this a material change and outside the scope of this exemptive relief.

³¹ Other activities, such as ETP redemptions, are not covered by this exemptive relief.

for compliance with these and any other applicable provisions of the federal securities laws must rest with the persons relying on this exemption. This order does not represent Commission views with respect to any other question that the proposed activities may raise, including, but not limited to the adequacy of the disclosure required by federal securities laws and rules, and the applicability of other federal or state laws and rules to, the proposed activities.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³²

Kevin M. O'Neill
Deputy Secretary

³² 17 CFR 200.30-3(a)(6).