

## SECURITIES AND EXCHANGE COMMISSION

Release No. 34-71805

March 26, 2014

### Order Granting a Limited Exemption from Rule 102 of Regulation M Concerning the NYSE Arca, Inc.'s Crowd Participant Program Pilot

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 7.25 (“New Rule 7.25”) which establishes the Crowd Participant (“CP”) Program (“CP Program” or “Program”) effective for one year on a pilot basis. The CP Program permits certain market makers to become CPs, a new class of equity trading permit holders.<sup>1</sup> The Exchange states that the CP Program is designed to incentivize quoting and trading volume in certain low-volume exchange-traded products (“ETPs”) by providing credit to CPs for certain market making activity that is funded by participating issuers and credited to CPs from the Exchange’s general revenues.<sup>2</sup> Participating issuers (or sponsors on behalf of the issuer) fund the Program by paying non-refundable “CP Program Fees,” which are then credited to the Exchange’s general revenues.<sup>3</sup> The Commission believes that payment of the CP Program Fee by the issuer (or a

---

<sup>1</sup> See New Rule 7.25(a) (establishing the requirements to be a CP); see also NYSE Arca Equities Rule 1.1(m) and (n) (defining equity trading permits/ETPs and ETP holders) and Securities Exchange Act Release No. 71804 (March 26, 2014) (NYSE Arca 2013-141) (“Approval Order”) (providing more details regarding the Program).

<sup>2</sup> See Approval Order. The Approval Order contains a detailed description of the Program. The proposed rule change was published for comment in the Federal Register on December 26, 2013. Securities Exchange Act Release No. 71146 (Dec. 19, 2013), 78 FR 78426 (Dec. 26, 2013). The Approval Order grants approval of the proposed rule change, as modified by Amendment No. 2.

<sup>3</sup> The program is similar to other programs, such as NYSE Arca’s “ETP Incentive Program” and NASDAQ Stock Market LLC’s “Market Quality Program,” designed to permit ETP issuers to pay incentives to those who make markets in their ETPs. See

sponsor on behalf of the issuer) for the purpose of incentivizing market makers to participate as a CP 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.<sup>4</sup> As a result, absent exemptive relief, participation in the CP Program by an issuer (or sponsor on behalf of the issuer) would violate Rule 102 of Regulation M.<sup>5</sup> 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 CP Program is designed to incentivize market makers to quote and trade in certain low-volume ETPs.<sup>6</sup> In addition, the Exchange states that the Program is

---

Securities Exchange Act Release No. 69706 (June 6, 2013); 78 FR 35340 (June 12, 2013) (NYSEArca 2013-34) and Securities Exchange Act Release No. 69195 (Mar. 20, 2013); 78 FR 18393 (Mar. 26, 2013) (NASDAQ 2012-137); see also Securities Exchange Act Release No. 69707 (June 6, 2013); 78 FR 35330 (June 12, 2013) (approving a limited exception from Rule 102 of Regulation M concerning NYSE Arca's ETP Incentive Program pilot) and Securities Exchange Act Release No. 69196 (Mar. 20, 2013); 78 FR 18410 (Mar. 26, 2013) (approving a limited exception from Rule 102 of Regulation M concerning NASDAQ Stock Market LLC's Market Quality Program pilot).

<sup>4</sup> See Securities Exchange Act Release No. 67411 (July 11, 2012), 77 FR 42052 (July 17, 2012) (stating that "[t]he Commission believes that issuer payments made under the [similar ETP Incentive and Market Quality Programs] 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" and that "[u]nder the [similar ETP Incentive Program], the purpose of the Program is 'to create [an 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"). Similarly, the issuer pays for the CP Program for the stated purpose of incentivizing market makers to quote and trade in certain low-volume ETPs, which also could induce bids or purchases for the issuer's security during a restricted period. See Approval Order.

<sup>5</sup> 17 CFR 242.102.

<sup>6</sup> See Approval Order.

designed to add competition among existing qualified Market Makers on the Exchange.<sup>7</sup> The Exchange states that the CP Program will offer an alternative to the existing Lead Market Maker program on the Exchange and the ETP Incentive Program (under NYSE Arca Equities Rule 8.800) for issuers to consider when determining where to list their securities.<sup>8</sup>

An issuer of an ETP that participates in the CP Program would elect to pay a “CP Program Fee” to NYSE Arca in an amount ranging from \$50,000 to \$100,000 per year, with the actual amount to be determined by the issuer.<sup>9</sup> The CP Program Fee is in addition to the current listing and annual fees applicable to the ETP and is paid by the issuer to the Exchange’s general revenues.<sup>10</sup> Subject to the requirements set forth in New Rule 7.25, a CP participating in the CP Program would receive a payment monthly from NYSE Arca (“CP Payment”) in an amount not to exceed the CP Program Fee, less a 5% NYSE Arca administration fee, divided by the number of trading days in the calendar year.<sup>11</sup> The payment structure of the CP Payment is specified in the Trading Fee Schedule and tied to the performance of the CP.<sup>12</sup> If no CP is eligible to receive a CP Payment because the CP Program performance standards were not met by any CP, no CP

---

<sup>7</sup> Id.

<sup>8</sup> Id.

<sup>9</sup> Id.

<sup>10</sup> Id.

<sup>11</sup> Id.

<sup>12</sup> Id.

would receive a CP Payment.<sup>13</sup> The voluntary Program established by New Rule 7.25 will be effective for one year on a pilot basis.<sup>14</sup>

Under New Rule 7.25, NYSE Arca will be required to provide notification on its website regarding: (i) the ETPs participating in the CP Program, (ii) the date a particular ETP begins participating in the CP Program, (iii) the date the Exchange receives written notice of an issuer's intent to withdraw its ETP from the CP Program, and the intended withdrawal date, if provided, (iv) the date a particular ETP ceases participating in the CP Program, (v) the CPs assigned to each ETP participating in the CP Program, (vi) the date the Exchange receives written notice of a CP's intent to withdraw from its ETP assignment(s) in the CP Program, and the intended withdrawal date, if provided, and (vii) the amount of the CP Program Fee for each ETP.<sup>15</sup> This page would also include a fair and balanced description of the CP Program, including (i) a description of the CP 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 CP Program, (iii) the potential risks that may be attendant with an ETP's participation in the CP Program, (iv) the potential impact resulting from an ETP's entry into and exit from the CP Program, and (v) how interested parties can request additional information regarding the CP Program and/or the ETPs participating therein.<sup>16</sup> Furthermore, an issuer that is approved to participate in the CP Program shall issue a press release to the public, in a form and manner prescribed by the Exchange, when

---

<sup>13</sup> Id.

<sup>14</sup> Preamble to New Rule 7.25.

<sup>15</sup> New Rule 7.25(c)(4).

<sup>16</sup> Id.

it commences participation or ceases to participate in the CP Program.<sup>17</sup> Such press release would be issued, if practicable, at least two days before the ETP commences or ceases participation in the CP Program.<sup>18</sup> 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.<sup>19</sup>

The Commission received no comments on the proposal.<sup>20</sup> However, certain commenters expressed concerns about similar ETP Incentive and Market Quality Programs,<sup>21</sup> 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.<sup>22</sup> In particular, commenters to those

---

<sup>17</sup> New Rule 7.25(c)(5).

<sup>18</sup> Id.

<sup>19</sup> Id.

<sup>20</sup> See Approval Order.

<sup>21</sup> See note 2, supra.

<sup>22</sup> 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, in which he stated, “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

similar proposals discussed the potential distortive impact on the natural market forces of supply and demand.<sup>23</sup> Commenters to those proposals also discussed what they viewed as the failure of those programs, as originally conceived, to adequately mitigate their potential negative impacts.<sup>24</sup>

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.”<sup>25</sup> One commenter questioned whether any safeguards could alleviate their concerns regarding issuer payments to market makers.<sup>26</sup> Another commenter questioned whether information relating to the similar Market Quality Program posted to that exchange’s website in a similar manner as required in New Rule 7.25(c)(4) 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.<sup>27</sup>

---

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.

<sup>23</sup> See, e.g., Letter from F. William McNabb, Chairman and Chief Executive Officer, Vanguard, dated Aug. 16, 2012.

<sup>24</sup> See, e.g., Letter from Gus Sauter, Managing Director and Chief Investment Officer, Vanguard, dated June 7, 2012.

<sup>25</sup> Letter from F. William McNabb, Chairman and Chief Executive Officer, Vanguard, dated Aug. 16, 2012.

<sup>26</sup> Letter from Ari Burstein, ICI, dated Aug. 16, 2012 (stating that “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”).

<sup>27</sup> Letter from Gus Sauter, Managing Director and Chief Investment Officer, Vanguard, dated (May 3, 2012) (asking whether it is likely that investors would consult NASDAQ’s website for information about which ETFs and market makers are participating in the NASDAQ Market Quality Program given what is known about investor behavior and, if not, asserting that “most investors would not be able to distinguish quotations that reflect

## **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 security<sup>28</sup> 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.<sup>29</sup> As mentioned above, the Commission believes that the payment of the CP Program Fee would constitute an indirect attempt to induce a bid for or purchase of a covered security during the applicable restricted period.<sup>30</sup> 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 7.25, 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 CP Program Fee as set forth in New Rule 7.25 during the pilot.<sup>31</sup> This limited exemption is conditioned on a requirement that the security participating in the Program

---

true market forces from quotations that have been influenced by issuer payments”).

<sup>28</sup> Covered security is defined as any security that is the subject of a distribution, or any reference security. 17 CFR 242.100(b).

<sup>29</sup> 17 CFR 242.102(a).

<sup>30</sup> See note 3, supra.

<sup>31</sup> 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.

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 CP Program 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 CP Program Fee on the natural market forces of supply and demand. The general disclosures required by New Rule 7.25, while helpful, may not be sufficient to obtain this result.<sup>32</sup> The required enhanced disclosures are expected to promote greater investor protection by helping to ensure that investors will have easier access to important information about a particular ETP.<sup>33</sup>

---

<sup>32</sup> New Rule 7.25(c)(5) 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's or sponsor's press release and webpage directly contain a number of helpful disclosures for investors, including risks of the program.

<sup>33</sup> 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 CP quotes and trades.

As a practical matter, these requirements are not intended to be duplicative with the issuer disclosures required by New Rule 7.25. These requirements can be satisfied via the press release and dedicated webpage required by New Rule 7.25(c)(5), 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).<sup>34</sup> 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 a CP Program Fee are hereby exempted from Rule 102 of Regulation M solely to permit the payment of the CP Program Fee as set forth in New Rule 7.25 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 7.25.

This exemption is subject to the following conditions:

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;

---

<sup>34</sup> See condition (4), infra.

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 a CP Program 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 CP Program 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 CP Program Fee as set forth in New Rule 7.25 for a security that is an ETP participating in the Program,<sup>35</sup> and does not extend to any other activities, any other security of

---

<sup>35</sup> All ETPs that are allowed to participate in the Program have a pool of underlying assets. See New Rule 7.25(b)(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

the trust related to the participating ETP, or any other issuers.<sup>36</sup> 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 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.<sup>37</sup>

Kevin M. O'Neill  
Deputy Secretary

---

would consider this a material change and outside the scope of this exemptive relief.

<sup>36</sup> Other activities, such as ETP redemptions, are not covered by this exemptive relief.

<sup>37</sup> 17 CFR 200.30-3(a)(6).