

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-64399; File No. SR-NYSEArca-2011-20)

May 4, 2011

Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Amending its Fee Schedule to Eliminate Registered Representative Fees for Options Trading Permit (“OTP”) Holders and to Institute a New Transaction-Based “Options Regulatory Fee”

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that, on April 28, 2011, NYSE Arca, Inc. (“NYSE Arca” or the “Exchange”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend its Fee Schedule to eliminate registered representative fees for Options Trading Permit (“OTP”) Holders and institute a new transaction-based “Options Regulatory Fee.” The text of the proposed rule change is available at the Exchange, at the Commission’s Public Reference Room, on the Commission’s website at [www.sec.gov](http://www.sec.gov), and [www.nyse.com](http://www.nyse.com).

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

This proposed rule change is based on a rule change previously submitted by NASDAQ OMX BX, Inc. on behalf of the Boston Options Exchange Group, LLC (“BOX”) that was effective upon filing.<sup>3</sup> The Exchange proposes to amend the NYSE Arca Fee Schedule to institute a new transaction-based “Options Regulatory Fee” and eliminate registered representative fees. Each OTP Holder or OTP Firm that registers an options principal and/or representative who is conducting business on NYSE Arca currently is assessed a registered representative fee (“RR Fee”) based on the action(s) associated with the registration. There are annual fees as well as initial, transfer and termination fees.<sup>4</sup> RR Fees and other regulatory fees collected by the Exchange were intended to cover only a portion of the cost of the Exchange’s regulatory programs. Prior to rule changes by other options exchanges, such as the Chicago

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<sup>3</sup> See Securities Exchange Act Release No. 61388 (January 20, 2010), 75 FR 4431 (January 27, 2010) (SR-BX-2010-001) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Registered Representative Fee and Options Regulatory Fee).

<sup>4</sup> In this regard, the Exchange proposes to eliminate from its options fee schedule any reference to fees the Exchange no longer asks FINRA to collect on its behalf relating to the processing of registered representatives. In particular, the following “Registration Fees” will be eliminated from the options fee schedule: the annual fee for new applications, maintenance, or transfer of registration status for each Registered Representative and each Registered Options Principal (collected by the NASD), the fee for termination of such individuals, the NASD CRD Processing Fee, the NASD Annual System Processing Fee, and the NYSE Arca Transfer/Re-license Individual Fee. Fees relating to the processing of registered representatives that FINRA collects and retains will remain in the Exchange’s options fee schedule. In particular, the following “Registration Fees” will remain in the options fee schedule: the NASD Disclosure Processing Fee and the NASD Manual Processing Fee for Fingerprint results submitted by other SROs.

Board Options Exchange (“CBOE”), BOX, NASDAQ OMX PHLX (“PHLX”) and the International Securities Exchange (“ISE”), all options exchanges, regardless of size, charged registered representative fees.

The Exchange believes that the current RR Fee is no longer equitable. The options industry has evolved to a structure with many more Internet-based and discount brokerage firms. These firms have few registered representatives and thus pay very little in RR Fees compared to full service brokerage firms that have many registered representatives. Further, due to the manner in which RR Fees are charged, it is possible for an NYSE Arca OTP Holder or OTP Firm to restructure its business to avoid paying these fees altogether. For example, a firm can avoid RR Fees by terminating its OTP status and sending its business to NYSE Arca through another separate NYSE Arca OTP Holder or OTP Firm, even an affiliated firm that has many fewer registered representatives. If firms terminated their OTP status to avoid RR Fees, the Exchange would suffer the loss of a source of funding for its regulatory programs. More importantly, the regulatory effort the Exchange expends to review the transactions of each type of firm is not commensurate with the number of registered representatives that each firm employs.

In order to address the inequity of the current regulatory fee structure and to offset more fully the cost of the Exchange’s regulatory programs, the Exchange proposes to eliminate the current RR Fee for NYSE Arca OTP Holders and OTP Firms and adopt an Options Regulatory Fee (“ORF”) of \$0.004 per contract.<sup>5</sup> As described below, this fee would be assessed by the

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<sup>5</sup> Because the annual component of the RR Fee has already been assessed for 2011, the Exchange will make a pro rata refund for the remaining portion of the year following elimination of the RR Fee. In addition, the Exchange notes that permit holders who conduct only equities business will no longer be subject to the RR Fee as a result of the elimination of this fee. Consequently, the Exchange proposes to eliminate from its

Exchange on each OTP Holder or OTP Firm for all options transactions executed or cleared by the OTP Holder or OTP Firm that are cleared by OCC in the customer range, regardless of the marketplace of execution. In particular, the Exchange would impose the ORF on all options transactions executed in the customer range by an OTP Holder or OTP Firm,<sup>6</sup> even if the transactions do not take place on NYSE Arca. The ORF would also be charged for transactions that are not executed by an OTP Holder or OTP Firm but are ultimately cleared by an OTP Holder. In the case where an OTP Holder or OTP Firm executes a transaction and a different OTP Holder or OTP Firm clears the transaction, the ORF would be assessed to the OTP Holder or OTP Firm who executes the transaction. In the case where a non-OTP Holder executes a transaction and an OTP Holder or OTP Firm clears the transaction, the ORF would be assessed to the OTP Holder or OTP Firm who clears the transaction.

As noted, the ORF would replace RR Fees, which relate to an OTP Holder or OTP Firm's options customer business. Further, RR Fees constituted the single-largest fee assessed that is

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NYSE Arca Equities fee schedule any reference to fees the Exchange no longer asks FINRA to collect on its behalf relating to the processing of Registered Representatives. In particular, the following "Registration Fees" will be eliminated from the equities fee schedule: the annual fee for new applications, maintenance, or transfer of registration status for each Registered Representative and each Registered Principal (collected by the NASD), the two NASD CRD Processing Fees, the NASD Annual System Processing Fee, and the NYSE Arca Transfer/Re-license Individual Fee. Fees relating to the processing of registered representatives that FINRA collects and retains will remain in the Exchange's equities fee schedule. In particular, the following "Registration Fees" will remain in the equities fee schedule: the NASD Disclosure Processing Fee and the NASD Manual Processing Fee for Fingerprint Results submitted by Other SROs. The Exchange will separately submit a rule filing to address funding for equities regulation.

<sup>6</sup> Such transactions must be cleared by an OTP Holder or OTP Firm in the customer range for the ORF to apply. Subject to the foregoing, the ORF would apply to all customer orders executed by an OTP Holder or OTP Firm on NYSE Arca. Exchange rules require each OTP Holder or OTP Firm to submit trade information in order to allow the Exchange to properly prioritize and match orders and quotations and report resulting transactions to the OCC. See NYSE Arca Rule 6.68. The Exchange represents that it has surveillances in place to verify that OTP Holders comply with the rule.

related to regulation of customer trading activity, and the Exchange believes it is appropriate to charge the ORF only to transactions that clear as customer at the OCC. The Exchange believes that its broad regulatory responsibilities with respect to an OTP Holder or OTP Firms' activities supports applying the ORF to transactions cleared but not executed by an OTP Holder or OTP Firm. The Exchange's regulatory responsibilities are the same regardless of whether an OTP Holder or OTP Firm executes a transaction or clears a transaction executed on its behalf. The Exchange regularly reviews all such activities, including performing surveillance for position limit violations, manipulation, front-running, contrary exercise advice violations and insider trading.<sup>7</sup> These activities span across multiple exchanges.

The Exchange believes the initial level of the fee is reasonable because it relates to the recovery of the costs of supervising and regulating an OTP Holder or OTP Firm's customer options business. The Exchange believes the amount of the ORF is fair and reasonably allocated because it is a closer approximation to the Exchange's actual costs in administering its regulatory program with respect to customer options activity.

The ORF would be collected indirectly from OTP Holder or OTP Firms through their clearing firms by OCC on behalf of the Exchange. The Exchange expects that OTP Holders and OTP Firms will pass-through the ORF to their customers in the same manner that firms pass-

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<sup>7</sup> The Exchange also participates in The Options Regulatory Surveillance Authority ("ORSA") national market system plan and in doing so shares information and coordinates with other exchanges designed to detect the unlawful use of undisclosed material information in the trading of securities options. ORSA is a national market system comprised of several self-regulatory organizations whose functions and objectives include the joint development, administration, operation and maintenance of systems and facilities utilized in the regulation, surveillance, investigation and detection of the unlawful use of undisclosed material information in the trading of securities options. The Exchange compensates ORSA for the Exchange's portion of the cost to perform insider trading surveillance on behalf of the Exchange. The ORF will cover the costs associated with the Exchange's arrangement with ORSA.

through to their customers the fees charged by Self Regulatory Organizations (“SROs”) to help the SROs meet their obligations under Section 31 of the Exchange Act.

The ORF is designed to recover a material portion of the costs to the Exchange of the supervision and regulation of OTP Holders and OTP Firms, including performing routine surveillances, investigations, as well as policy, rulemaking, interpretive and enforcement activities.<sup>8</sup> The Exchange believes that revenue generated from the ORF will cover the substantial majority of the Exchange’s regulatory costs related to the NYSE Arca options market. At present, RR Fees make up the largest part of the Exchange’s total options regulatory fee revenue, however, the total amount of NYSE Arca specific regulatory fees collected by the Exchange is significantly less than the regulatory costs incurred by NYSE Arca on an annual basis. The Exchange notes that its regulatory responsibilities with respect to an OTP Holder or OTP Firm’s compliance with options sales practice rules have been allocated to FINRA under a 17d-2 agreement. The ORF is not designed to cover the cost of options sales practice regulation.

The Exchange would monitor the amount of revenue collected from the ORF to ensure that it, in combination with its other NYSE Arca regulatory fees and fines, does not exceed the Exchange’s total regulatory costs. The Exchange expects to monitor NYSE Arca regulatory costs and revenues at a minimum on an annual basis. If the Exchange determines NYSE Arca regulatory revenues exceed regulatory costs, the Exchange would adjust the ORF by submitting a fee change filing to the Commission. The Exchange would notify OTP Holders and OTP Firms of adjustments to the ORF via a Regulatory Bulletin.

The Exchange believes the proposed ORF is equitably allocated because it would be charged to all OTP Holders and OTP Firms on all their customer options business. The

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<sup>8</sup> As stated above, the RR Fees collected by the Exchange were originally intended to cover only a portion of the cost of the Exchange’s regulatory programs.

Exchange believes the proposed ORF is reasonable because it will raise revenue related to the amount of customer options business conducted by an OTP Holder or OTP Firm, and thus the amount of Exchange regulatory services those OTP Holders or OTP Firms will require with respect to that activity, instead of how many registered representatives a particular OTP Holder or OTP Firm employs.<sup>9</sup>

With almost all transactions on the Exchange conducted electronically, the amount of resources required by the Exchange to surveil non-customer trading activity is significantly less than the amount of resources the Exchange must dedicate to surveil customer trading activity. This is because surveilling customer trading activity is much more labor-intensive and requires greater expenditure of human and technical resources than surveilling non-customer trading activity, which tends to be more automated and less labor-intensive. As a result, the costs associated with administering the customer component of the Exchange's overall regulatory program are materially higher than the costs associated with administering the non-customer component (e.g., market maker) of its regulatory program.

The Exchange believes it is reasonable and appropriate for the Exchange to charge the ORF for options transactions regardless of the exchange on which the transactions occur. The Exchange has a statutory obligation to enforce compliance by OTP Holders and OTP Firms and their associated persons under the Exchange Act and the rules of the Exchange and to surveil for other manipulative conduct by market participants (including non-OTP Holders) trading on the Exchange. The Exchange cannot effectively surveil for such conduct without looking at and evaluating activity across all options markets. Many of the Exchange's market surveillance

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<sup>9</sup> The Exchange expects that implementation of the proposed ORF will result generally in many traditional brokerage firms paying less regulatory fees while Internet and discount brokerage firms will pay more.

programs require the Exchange to look at and evaluate activity across all options markets, such as surveillance for position limit violations, manipulation, front-running and contrary exercise advice violations/expiring exercise declarations.<sup>10</sup> Also, the Exchange and the other options exchanges are required to populate a consolidated options audit trail (“COATS”) system in order to surveil an OTP Holder or OTP Firm’s activities across markets.<sup>11</sup>

In addition to its own surveillance programs, the Exchange works with other SROs and exchanges on intermarket surveillance related issues. Through its participation in the Intermarket Surveillance Group (“ISG”),<sup>12</sup> the Exchange shares information and coordinates inquiries and investigations with other exchanges designed to address potential intermarket manipulation and trading abuses. The Exchange’s participation in ISG helps it to satisfy the Exchange Act requirement that it have coordinated surveillance with markets on which security futures are traded and markets on which any security underlying security futures are traded to detect manipulation and insider trading.<sup>13</sup>

The Exchange believes that charging the ORF across markets will avoid having OTP Holders and OTP Firms direct their trades to other markets in order to avoid the fee and to thereby avoid paying for their fair share of regulation. If the ORF did not apply to activity across

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<sup>10</sup> The Exchange and other options SROs are parties to a 17d-2 agreement allocating among the SROs regulatory responsibilities relating to compliance by the common members with rules for expiring exercise declarations, position limits, OCC trade adjustments, and Large Option Position Report reviews. See, e.g. Securities Exchange Act Release No. 61588 (February 25, 2010).

<sup>11</sup> COATS effectively enhances intermarket options surveillance by enabling the options exchanges to reconstruct the market promptly to effectively surveil certain rules.

<sup>12</sup> ISG is an industry organization formed in 1983 to coordinate intermarket surveillance among the SROs by cooperatively sharing regulatory information pursuant to a written agreement between the parties. The goal of the ISG’s information sharing is to coordinate regulatory efforts to address potential intermarket trading abuses and manipulations.

<sup>13</sup> See Exchange Act Section 6(h)(3)(I).



markets then an OTP Holder or OTP Firm would send their orders to the least cost, least regulated exchange. Other exchanges do impose a similar fee on their member's activity, including the activity of those members on NYSE Arca.<sup>14</sup>

The Exchange notes that there is established precedent for an SRO charging a fee across markets, namely, FINRA's Trading Activity Fee<sup>15</sup> and the CBOE's, PHLX's, ISE's and BOX's ORF. While the Exchange does not have all the same regulatory responsibilities as FINRA, the Exchange believes that, like other exchanges that have adopted an ORF, its broad regulatory responsibilities with respect to an OTP Holder or OTP Firms' activities, irrespective of where their transactions take place, supports a regulatory fee applicable to transactions on other markets. Unlike FINRA's Trading Activity Fee, the ORF would apply only to an OTP Holder or OTP Firm's customer options transactions.

The Exchange has designated this proposal to be operative on May 1, 2011.

## 2. Statutory Basis

Exchange believes the proposed rule change is consistent with Section 6(b) of the Act<sup>16</sup> in general, and furthers the objectives of Section 6(b)(4)<sup>17</sup> of the Act in particular, in that it is designed to provide for the equitable allocation of reasonable dues, fees, and other charges among its OTP Holders and OTP Firms and other persons using its facilities. The Exchange believes that the ORF is objectively allocated because it would be charged to all OTP Holders

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<sup>14</sup> The Exchange notes that CBOE currently assesses an options regulatory fee similar to the one proposed herein, which fee is also assessed on the trading activity of a CBOE member on NYSE Arca. See Securities Exchange Act Release No. 58817 (October 20, 2008), 73 FR 63744 (October 27, 2008). Similar regulatory fees have also been instituted by PHLX (See Securities Exchange Act Release No. 61133 (December 9, 2009), 74 FR 66715 (December 16, 2009) (SR-Phlx-2009-100)); and ISE (See Securities Exchange Act Release No. 61154 (December 11, 2009), 74 FR 67278 (December 18, 2009) (SR-ISE-2009-105)).

<sup>15</sup> See Securities Exchange Act Release No. 47946 (May 30, 2003), 68 FR 3402 (June 6, 2003).

and OTP Firms for all their transactions that clear as customer at the OCC through an OTP Holder or OTP Firm. Moreover, the Exchange believes the ORF ensures fairness by assessing higher fees to those participants that require more Exchange regulatory services based on the amount of customer options business they conduct.

The Exchange notes that the Commission has addressed the funding of an SRO's regulatory operations in the Concept Release Concerning Self-Regulation<sup>18</sup> and the release on the Fair Administration and Governance of Self-Regulatory Organizations.<sup>19</sup> In the Concept Release, the Commission states that: "Given the inherent tension between an SRO's role as a business and as a regulator, there undoubtedly is a temptation for an SRO to fund the business side of its operations at the expense of regulation."<sup>20</sup> In order to address this potential conflict, the Commission proposed in the Governance Release rules that would require an SRO to direct monies collected from regulatory fees, fines, or penalties exclusively to fund the regulatory operations and other programs of the SRO related to its regulatory responsibilities.<sup>21</sup> The Exchange has designed the ORF to generate revenues that, when combined with all of the Exchange's other regulatory fees, will be less than or equal to the Exchange's regulatory costs, which is consistent with the Commission's view that regulatory fees be used for regulatory purposes and not to support the Exchange's business side. In this regard, the Exchange believes that the initial level of the fee is reasonable.

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<sup>16</sup> 15 U.S.C. 78f (b).

<sup>17</sup> 15 U.S.C. 78f (b)(4).

<sup>18</sup> See Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256 (December 8, 2004) ("Concept Release").

<sup>19</sup> See Securities Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126 (December 8, 2004) ("Governance Release").

<sup>20</sup> Concept Release at 71268.

<sup>21</sup> Governance Release at 71142.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change is effective upon filing pursuant to Section 19(b)(3)(A)<sup>22</sup> of the Act and subparagraph (f)(2) of Rule 19b-4<sup>23</sup> thereunder, because it establishes a due, fee, or other charge imposed by the NYSE Arca.

At any time within 60 days of the filing of such proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NYSEArca-2011-20 on the subject line.

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<sup>22</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>23</sup> 17 CFR 240.19b-4(f)(2).

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSEArca-2011-20. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the

Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSEArca-2011-20 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>24</sup>

Elizabeth M. Murphy  
Secretary

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<sup>24</sup> 17 CFR 200.30-3(a)(12).