

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79599; File No. SR-NYSEMKT-2016-120)

December 19, 2016

Self-Regulatory Organizations; NYSE MKT LLC; Notice of Filing of Proposed Rule Change Amending Rule 971.1NY and to Make Permanent the Aspects of Customer Best Execution Auction that Are Subject to a Pilot

Pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (the “Act”)<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> notice is hereby given that on December 16, 2016, NYSE MKT LLC (the “Exchange” or “NYSE MKT”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. 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 Rule 971.1NY and to make permanent the aspects of Customer Best Execution Auction (“CUBE”) that are subject to a pilot, as amended. The proposed rule change is available on the Exchange’s website at [www.nyse.com](http://www.nyse.com), at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

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

<sup>2</sup> 15 U.S.C. 78a.

<sup>3</sup> 17 CFR 240.19b-4.

places 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend Rule 971.1NY to make permanent the aspects of Customer Best Execution Auction (“CUBE”) that are subject to a pilot. Currently, the provisions of Rule 971.1NY that govern execution of CUBE Orders of fewer than 50 contracts are operating on a pilot basis.<sup>4</sup> The Exchange proposes to make these provisions permanent and introduce an additional scenario when the Exchange would reject a CUBE Order for fewer than 50 contracts.

Background

Rule 971.1NY sets forth an electronic crossing mechanism for single-leg orders with a price improvement auction on the Exchange, referred to as the CUBE (or the “CUBE Auction”).<sup>5</sup> The CUBE Auction, which was approved in April 2014, is designed to provide price improvement for paired orders of any size.<sup>6</sup> Two aspects of the CUBE were approved on a pilot basis – Rule 971.1NY(b)(1)(B), which establishes the permissible range of executions for CUBE Auctions for fewer than 50 contracts; and Rule 971.1NY(b)(8), which establishes that the minimum size for a CUBE Auction is one contract (together, the “CUBE Pilot”).

To commence an Auction, an ATP Holder (“Initiating Participant”) may electronically submit for execution a limit order it represents as agent on behalf of a public customer, broker dealer, or any other entity (“CUBE Order”). The Initiating Participant would agree to guarantee

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<sup>4</sup> See Commentary .01 to Rule 971.1NY and Rules 971.1NY(b)(1)(B) and (b)(8).

<sup>5</sup> See generally Rule 971.1NY (Electronic Cross Transactions).

<sup>6</sup> See Securities Exchange Act Release No. 72025 (April 25, 2014), 79 FR 24779 (May 1, 2014) (NYSEMKT-2014-17) (the “CUBE Approval Order”).

the execution of the CUBE Order by submitting a contra-side order representing principal interest or interest it has solicited to trade with the CUBE Order at a specified price (the “single stop price”) or by utilizing auto-match or auto-match limit.<sup>7</sup>

Rule 971.1NY(b)(1) sets forth the permissible range of executions for a CUBE Order.<sup>8</sup> Pursuant to the CUBE Pilot, a CUBE Order for fewer than 50 contracts is subject to tighter ranges of execution than larger CUBE Orders to maximize price improvement.<sup>9</sup> Specifically, if the CUBE Order is for fewer than 50 contracts, the range of permissible execution will be equal to or better than the National Best Bid/Offer (“NBBO”), provided that such price must be at least one cent better than any displayed interest in the Exchange’s Consolidated Book.<sup>10</sup>

The CUBE Pilot was initially approved for a one-year pilot, and has since been extended for three subsequent years.<sup>11</sup> Pursuant to Commentary .01 to Rule 971.1NY, the CUBE Pilot would, if not amended or made permanent, end on January 18, 2017.<sup>12</sup>

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<sup>7</sup> See Rule 971.1NY(c)(1)(A)-(C). In addition, CUBE provides for the automatic execution, under certain conditions, of a crossing transaction where there is a public customer order in the same options series on each side.

<sup>8</sup> Subject to specified exceptions, a CUBE Order to buy (sell) may execute at prices equal to or between the initiating price as the upper (lower) bound and the National Best Bid (“NBB”) (National Best Offer (“NBO”)) as the lower (upper) bound. See Rule 971.1NY(b).

<sup>9</sup> See Rule 971.1NY(b)(1)(B). See also Rule 971.1NY(b)(8) (also part of the CUBE Pilot, providing that the minimum size for a CUBE Auction is one contract).

<sup>10</sup> See Rule 971.1NY(b)(1)(B).

<sup>11</sup> See CUBE Approval Order, *supra*, note 6. The CUBE Pilot was subsequently extended, most recently until January 18, 2017, to align the expiration of the pilot period with that of other competing options exchange that offer electronic price improvement auctions similar to the CUBE. See Securities Exchange Act Release Nos. 74695 (April 9, 2015), 80 FR 20274 (April 15, 2015) (SR-NYSEMKT-2015-28); 75460 (July 15, 2015), 80 FR 43141 (July 21, 2015) (SR-NYSEMKT-2015-48); 78324 (July 14, 2016), 81 FR 47196 (July 20, 2016) (SR-NYSEMKT-2016-69).

<sup>12</sup> In connection with the CUBE Pilot, the Exchange has provided specified data to the Commission to provide supporting evidence that, among other things, there is meaningful

### Proposal to Make CUBE Pilot Permanent

The Exchange implemented the CUBE Auction to provide an electronic crossing mechanism for single-leg orders with a price improvement auction to create tighter markets and ensure that each order receives the best possible price. The Exchange believes that the CUBE Pilot attracts order flow and promotes competition and price improvement opportunities for CUBE Orders of fewer than 50 contracts. The Exchange therefore proposes to make permanent the CUBE Pilot before it expires on January 18, 2017.

In connection with the proposal to make the CUBE Pilot permanent, the Exchange proposes to modify Rule 971.1NY to introduce an additional scenario when a CUBE Order for fewer than 50 contracts would either be rejected or require price improvement. Currently, Rule 971.1NY(b)(6) provides that CUBE Orders for fewer than 50 contracts that are submitted when the BBO is \$0.01 wide will be rejected. The Exchange proposes to amend this rule to provide that CUBE Orders for fewer than 50 contracts entered when the NBBO is \$0.01 wide would be rejected unless they are guaranteed a penny of price improvement. To reflect this change, the Exchange proposes to amend Rule 971.1NY(b)(6) to provide that CUBE Orders for fewer than 50 contracts would be rejected when (A) the BBO is \$0.01 wide (i.e., the current requirement); or (B) the NBBO is \$0.01 wide, unless the Initiating Participant guarantees the execution of the CUBE Order to buy (sell) at a price that is equal to the NBO minus one cent (NBB plus one cent), utilizing a single stop price, auto-match, or auto-match limit as specified in paragraphs (c)(1)(A) – (C) of Rule 971.1NY. Accordingly, as proposed, the Exchange would reject a CUBE

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competition for all size orders and that there is an active and liquid market functioning on the Exchange outside of the CUBE Auction. See CUBE Approval Order, supra note 6, 79 FR at 24785-86, fn. 94-95; Commentary .01 to Rule 971.1NY. See also Securities Exchange Act Release No. 78324 (July 14, 2016), 81 FR 47196 (July 20, 2016) (SR-NYSEMKT-2016-69).

Order for fewer than 50 contracts when the NBBO is \$0.01 wide unless the Initiating Participant guarantees a penny of price improvement.<sup>13</sup>

The Exchange believes this proposal would further the goal of the CUBE Auction, as the CUBE Order would be “guaranteed an execution price of at least NBBO at the time the CUBE Auction commences and, moreover, would be given an opportunity for price improvement beyond the NBBO by being exposed to ATP Holders during the CUBE Auction.”<sup>14</sup> The proposal would guarantee price improvement in penny-wide markets by requiring the Initiating Participant to guarantee to improve the contra-side NBBO when the spread is \$0.01 wide at the time the CUBE Order for fewer than 50 contracts is submitted – such that the Initiating Participant would agree to buy at the bid or sell at the offer.

In connection with the proposal to make permanent the CUBE Pilot (i.e., Rules 971.1NY(b)(1)(B) and 971.1NY(b)(8)), the Exchange proposes to delete Commentary .01 to Rule 971.1NY, which describes the CUBE Pilot and the Exchange’s associated obligation to produce data, to hold this paragraph as “Reserved.”<sup>15</sup>

The Exchange has analyzed the data gathered during the CUBE Pilot (the “CUBE Data”) and believes the CUBE Data indicates that there is meaningful competition in CUBE Auctions for all size orders, regardless of the size of the order or the bid/ask differential of the NBBO.<sup>16</sup>

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<sup>13</sup> The proposal would not alter the separate price improvement requirement set forth in Rule 971.1NY(b)(1)(B), which establishes the range of permissible execution prices for CUBE Orders of fewer than 50 contracts will be equal to or better than the NBBO and at least one cent better than any displayed interest in the Exchange’s Consolidated Book. See also Rule 971.1NY(b)(2)-(9) (delineating reasons CUBE Orders would be rejected, none of which would be altered by this proposal).

<sup>14</sup> See CUBE Approval Order, supra note 6 at 79 FR 24779, at 24787.

<sup>15</sup> See proposed Commentary .01 to Rule 971.1NY. The Exchange notes that it would retain the text of Rules 971.1NY(b)(1)(B) and 971.1NY(b)(8).

<sup>16</sup> See Exhibit 3 (summary of the CUBE Data from January - June 2015).

Specifically, between January and June 2015, a total of 4,493,429 contracts were executed in CUBE Auctions. Market Makers and other participants submitted competitive bids and offers during the CUBE Auction's Response Time Interval, indicating interest in participating in CUBE Auction trades. In addition, the Exchange believes the allocation of orders executed in CUBE Auctions – either at a single price or multiple prices – supports competitive bidding and offering.

The Exchange also believes that the CUBE Data reveals that there is an active and liquid market functioning on the Exchange outside of the CUBE Auction,<sup>17</sup> Competitive bidding and offering occurs outside of CUBE Auction and participants can submit bids/offers at improved prices or join a bid or offer (thus improving liquidity at that price) regardless of the bid/ask differential of the NBBO.

Although the Exchange continues to believe that the CUBE Auction provides opportunities for price improvement of CUBE Orders (i.e., the agency order) with a size of less than 50 contracts when the NBBO has a bid/ask differential of \$0.01 (e.g. because the market conditions may change during the CUBE Auction), the data have not demonstrated significant price improvement in this narrow circumstance. Between January and June 2015, a total of 171,822 contracts were executed in CUBE Auctions for fewer than 50 contracts when the NBBO had a bid/ask differential of \$0.01. Only 1,660 of those contracts received price improvement of \$0.01. Thus, consistent with the Exchange's view that price improvement auctions should provide improvement, particularly for small orders, the Exchange is proposing to require that Initiating Participants guarantee price improvement for CUBE Orders for 50 or fewer contracts in such market conditions.

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<sup>17</sup> From January 2015 through June 2015, the Exchange executed a total of 152,193,516 contracts outside of CUBE Auctions, which the Exchange believes is indicative of an active and liquid market functioning on the Exchange outside of the CUBE Auctions.

Further, the Exchange notes that CUBE Auctions for fewer than 50 contracts have served as a valuable tool in providing price improvement when the NBBO has a bid/ask differential of greater than \$0.01. For example, for CUBE Auctions of this size, the CUBE Data indicates that when the NBBO has a bid/ask differential between \$0.02 and \$0.05, contracts executed in CUBE Auctions received on average a price improvement of \$0.0114. In wider markets (i.e., bid/ask differentials greater than \$0.05), contracts executed in CUBE Auctions received, on average, price improvement of more than \$0.0759.

In the CUBE Approval Order, the Commission stated that “the Exchange’s proposal [for the CUBE Pilot] should provide small customer orders with the opportunity for price improvement in a manner that is consistent with the Act.”<sup>18</sup>

Based on a review of the CUBE Data, the Exchange believes that the CUBE Auction, as modified herein, would allow the Exchange to continue to provide meaningful competition for all size orders – including small orders – as well as to continue to offer an active and liquid market outside of the CUBE Auction. Thus, the Exchange believes it would be beneficial to customers and to the options market to make the CUBE Pilot permanent, as amended. Once permanent, the CUBE Auction would continue to accept orders of fewer than 50 contracts, provided such Orders comply with the modified CUBE rules, which should continue to attract small orders and promote competition and price improvement opportunities for such CUBE Orders.

#### Implementation

Because of the technology changes associated with the proposed amendment to Rule 971.1NY(b)(6), the Exchange proposes to announce the implementation of the proposed change

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<sup>18</sup> See CUBE Approval Order, supra note 6, 79 FR at 24787.

to the CUBE rules as well as the change to make the CUBE Pilot permanent, via Trader Update. Pending approval of this proposal by the Commission, the changes would be implemented prior to the expiration of the CUBE Pilot (i.e., before January 18, 2017).

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>19</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>20</sup> in particular, in that it is 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 Exchange believes the proposal to make permanent the CUBE Pilot would remove impediments to and perfect the mechanism of a free and open market and a national market system because the CUBE Pilot, together with the proposal to amend CUBE herein, are reasonably designed to create tighter markets and ensure that each order receives the best possible price, which benefits investors by increasing competition thereby maximizing opportunities for price improvement. In particular, the proposal to require that Initiating Participants guarantee improvement of \$0.01 (by buying at the bid or selling at the offer) on CUBE Orders for fewer than 50 contracts that are submitted when the NBBO is \$0.01 wide in order to participate in the CUBE promotes just and equitable principles of trade as it would ensure that small orders receive at least minimal price improvement, which may encourage the submission and execution of more orders of fewer than 50 contracts in CUBE, thus providing an increased probability of price improvement for smaller orders.

The proposal to make permanent the CUBE Pilot would also allow the applicable rules

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<sup>19</sup> 15 U.S.C. § 78f(b).

<sup>20</sup> 15 U.S.C. § 78f(b)(5).

(Rules 971.1NY(b)(1)(B) and 971.1NY(b)(8) to remain in effect, which would add certainty to Exchange rules and avoid any potential investor confusion that could result from a suspension or temporary interruption in the CUBE Pilot. Because the CUBE Pilot is applicable to all CUBE Orders for fewer than 50 contracts, and the requirement that the minimum size of the CUBE Auction is one contract, the proposal to make the Pilot permanent merely acts to maintain status quo on the Exchange, which promotes just and equitable principles of trade and removes impediments to, and perfects the mechanism of, a free and open market and a national market system.

The Exchange believes the proposed rule changes promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system because price improvement auctions are widely recognized by market participants as invaluable, both as a tool to access liquidity and a mechanism to help meet their best execution obligations. The Exchange believes the proposed rule changes would further the ability of market participants to carry out these strategies.

Finally, the Exchange believes that it is subject to significant competitive forces, as described below in the Exchange's statement regarding the burden on competition. For these reasons, the Exchange believes that the proposal is consistent with the Act.

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 not necessary or appropriate in furtherance of the purposes of the Act. The Exchange believes that making the CUBE Pilot permanent would continue to foster competition among liquidity providers and maintain execution quality on the Exchange. The CUBE Auction for small orders, as modified herein, would continue to operate to create tighter markets and

ensure that each order receives the best possible price, which benefits investors by increasing competition thereby maximizing opportunities for price improvement.

The Exchange notes that it operates in a highly competitive market in which market participants can easily direct their orders to competing venues. In such an environment, the Exchange must continually review, and consider adjusting the services it offers and the requirements it imposes to remain competitive with other exchanges. For the reasons described above, the Exchange believes that the proposed rule change reflects this competitive environment.

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

Within 45 days of the date of publication of this notice in the Federal Register or up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

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-NYSEMKT-2016-120 on the subject line.

Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSEMKT-2016-120. 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-NYSEMKT-2016-120 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>21</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>21</sup> 17 CFR 200.30-3(a)(12).