

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 Web site 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 such 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-2012-38 and should be submitted on or before June 7, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

**Kevin M. O'Neill,**  
*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-66966; File No. SR-NYSEArca-2012-37]

### Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing of Proposed Rule Change Proposing a Pilot Program To Create a Lead Market Maker Issuer Incentive Program for Issuers of Certain Exchange-Traded Products Listed on NYSE Arca, Inc.

May 11, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that, on April 27, 2012, NYSE Arca, Inc. ("Exchange" or "NYSE Arca") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II and III below, which Items have been substantially 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 a pilot program to create a Lead Market Maker ("LMM") Issuer Incentive Program ("Fixed Incentive Program") for issuers of certain exchange-traded products ("ETPs") listed on the Exchange. The text of the proposed rule change is available at the Exchange, [www.nyse.com](http://www.nyse.com), the Commission's Public Reference Room, and the Commission's Web site at [www.sec.gov](http://www.sec.gov).

#### 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 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

The Exchange proposes a pilot program to create a Fixed Incentive Program for issuers of certain ETPs listed on the Exchange.

###### Background

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.<sup>3</sup> ETP issuers also pay a graduated Annual Fee based on the number of shares of the ETP that are outstanding. The Annual Fee ranges from \$5,000 to \$55,000.

A qualified Market Maker may request an assignment as an LMM for an ETP, and the request is subject to approval by the Exchange.<sup>4</sup> For some ETPs, no Market Maker requests an assignment as

<sup>3</sup> The Exchange has one Schedule of Fees and Charges for Exchange Services that is for listings ("Listing Fee Schedule") and another that is for trade-related charges ("Trading Fee Schedule"). To differentiate them, the Exchange proposes to change the name of the former to "SCHEDULE OF FEES AND CHARGES FOR EXCHANGE LISTING SERVICES." ETPs are generally classified as either Derivative Securities Products or Structured Products for purposes of the Listing Fee Schedule. See Listing Fee Schedule, available at [http://www.nyse.com/pdfs/NYSEArca\\_Listing\\_Fees.pdf](http://www.nyse.com/pdfs/NYSEArca_Listing_Fees.pdf).

<sup>4</sup> See NYSE Arca Equities Rule 7.22(d).

an LMM, and the ETP therefore trades without an LMM assigned to it. The Exchange operates under the price-time priority model for all market participants, so there is no distinct transactional benefit to being assigned as an LMM. However, LMMs are obligated to meet certain obligations and requirements<sup>5</sup> and therefore incur greater risks than other market participants on the Exchange. The risks include those associated with managing position inventory as well as those associated with maintaining quotes. Inventory risks may be higher for certain ETPs with low volume and low shares outstanding because there are fewer opportunities to turn over positions in such ETPs and the accumulation of costs from carrying those positions as well as positions in the underlying securities used for hedging.<sup>6</sup> LMMs are required to continuously quote on both sides of the market; therefore, they must be willing to buy as well as sell by posting displayed and firm quotes on the Exchange. When there is a low volume of shares outstanding, there is often less supply for securities lending purposes. In order to meet settlement requirements established by Regulation SHO,<sup>7</sup> LMMs acting in ETPs with low shares outstanding are often required to maintain a long ETP position. Quoting risks exist due to the complexity of pricing ETPs and the potential for human and/or technological errors. ETPs are open-ended and derivatively priced securities that typically track returns of underlying assets. If, due to human error such as the input of an inaccurate underlying basket or technological error such as a static data

<sup>5</sup> An LMM is subject to the obligations for Market Makers that are set forth in NYSE Arca Equities Rule 7.23 and the minimum performance standards that are referenced in NYSE Arca Equities Rule 7.24. Under NYSE Arca Equities Rule 7.24, the minimum performance standards include (i) percent of time at the National Best Bid or Offer ("NBBO"), (ii) percent of executions better than the NBBO, (iii) average displayed size, (iv) average quoted spread, and (v) in the event the security is a derivative security, the ability to transact in underlying markets. An LMM's minimum performance standards are higher than those of a Designated Market Maker and are described in an official NYSE Arca policy titled *NYSE Arca LMM Requirements*, which may be amended from time to time. The minimum performance standards are measured daily and reviewed as a monthly average. The Exchange believes that they are stringent and help foster liquidity provision and stability in the market. References in this rule filing, including in the proposed rule text, to an LMM's minimum performance standards mean those set forth in *NYSE Arca LMM Requirements*.

<sup>6</sup> Costs of carrying ETP inventories include the expense ratio, which includes the management fee, financing costs or the cost of capital, and the opportunity cost of allocating capital. At times it may also include stock loan costs for maintaining a hedge in hard-to-borrow securities.

<sup>7</sup> See 17 CFR 242.203-204.

<sup>15</sup> 17 CFR 200.30-3(a)(12).

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

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

feed caused by networking or hardware breakdowns, the LMM's quote diverges from the underlying assets value, the LMMs are more likely to buy (sell) at prices that are above (below) theoretical fair values. Because LMMs are required to continuously quote on both sides of the market and maintain certain minimum performance standards, they are more likely to face these types of risks because other market participants have more freedom to withdraw quotes upon experiencing difficulties or unusual market conditions.

To incentivize firms to take on the LMM designation and foster liquidity provision and stability in the market,

the Exchange currently provides LMMs with an opportunity to receive incrementally higher transaction credits and incur incrementally lower transaction fees ("LMM Rates") compared to standard liquidity maker-taker rates ("Standard Rates").<sup>8</sup> LMM Rates are intended to balance the increased risks and requirements assumed by LMMs. Accordingly, the value of acting as an LMM could be measured by the incremental difference in the transaction credits or fees under the LMM Rates as compared to the Standard Rates. However, the absolute incremental difference depends on the

LMM's volume traded. Trading volume for different ETPs can vary significantly and result in a corresponding variance in LMM trading volume. The benefit of acting as an LMM can therefore vary significantly depending upon the ETP to which the LMM is assigned. There are fewer financial benefits for LMM assignments in ETPs with lower CADV than ETPs with higher CADV. The table below provides hypothetical examples based on assumptions that NYSE Arca market share equals 22%, LMM participation rate equals 20%, LMM make ratio equals 80%, and LMM take ratio equals 20%:<sup>9</sup>

| Symbol    | CADV       | Annual transaction credit/fee (LMM rates) | Annual transaction credit/fee (standard rates) | Annual incremental difference |
|-----------|------------|---|--|-------------------------------|
| ABC ..... | 25,000,000 | \$637,560                                 | \$332,640                                      | \$304,920                     |
| DEF ..... | 5,100,000  | 130,062                                   | 67,859   | 62,204                        |
| GHI ..... | 2,500,000  | 74,844                                    | 33,264   | 41,580                        |
| JKL ..... | 1,100,000  | 32,931                                    | 14,636   | 18,295                        |
| MNO ..... | 750,000    | 25,780                                    | 9,979  | 15,800                        |
| PQR ..... | 500,000    | 17,186                                    | 6,653  | 10,534                        |
| STU ..... | 100,000    | 3,437                                     | 1,331  | 2,107                         |
| VWX ..... | 10,000     | 344                                       | 133  | 211                           |
| YZ .....  | 1,000      | 34  | 13   | 21                            |

The Exchange believes that the assignment of an LMM, which is held to higher standards as compared to Market Makers and other market participants, is a critical component of the promotion of a consistent, fair and orderly market in ETPs on the Exchange. However, market

participants may be forgoing LMM assignments in ETPs—instead choosing to trade ETPs as Market Makers or ETP Holders with lower or no obligations or minimum performance standards—because the incentives to serve as an LMM are insufficient to outweigh the

obligations, minimum performance standards, and other risks described above. To illustrate how this change has transpired, the following table highlights the increasing proportion of new NYSE Arca ETPs that are listed without an LMM present:

|                                  | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|----------------------------------|------|------|------|------|------|------|------|------|------|
| New NYSE Arca ETP Listings ..... | 11   | 34   | 49   | 133  | 223  | 195  | 124  | 196  | 297  |
| Listed with LMM .....            | 11   | 34   | 49   | 133  | 218  | 190  | 121  | 175  | 271  |
| Listed without LMM .....         | 0    | 0    | 0    | 0    | 5    | 5    | 3    | 21   | 26   |

Since January 2008, nearly 100% of all LMM withdrawal requests for ETPs already listed and trading were made for securities that exhibited low CADV in the period prior to the withdrawal request being made. This behavior signals a connection between low CADV and low interest levels from firms seeking to act as the LMM. Likewise, it supports the assertion that there is less

value relative to risks of acting as the LMM for certain ETPs.

**Proposed Fixed Incentive Program**

The Exchange proposes to add new NYSE Arca Equities Rule 8.800, which would offer a pilot program to incentivize Market Makers to undertake LMM assignments in ETPs. An issuer of an ETP that participates in the proposed

Fixed Incentive Program would continue to pay the currently applicable Listing and Annual Fees. Such issuer also could elect to pay the Exchange an Optional Incentive Fee, which would range from \$10,000 to \$40,000 per year.<sup>10</sup>

Proposed NYSE Arca Equities Rule 8.800(a) would describe the ETPs that would be eligible for inclusion in the

<sup>8</sup> The Exchange generally employs a maker-taker transactional fee structure, whereby an ETP Holder that removes liquidity is charged a fee ("Take Rate"), and an Equity Trading Permit Holder ("ETP Holder") that provides liquidity receives a credit ("Make Rate"). The Take Rate for LMMs is currently \$0.0025 per share. The Make Rate for LMMs is currently between \$0.0035 and \$0.0045 per share depending on consolidated average daily volume ("CADV"). Standard NYSE Arca Tape B Make Rates (rebates paid for adding liquidity) range from

\$0.0022 to \$0.0033 per share. Standard NYSE Arca Tape B Take Rates (fees charged for removing liquidity) range from \$0.0026 to \$0.0030 per share. See the Trading Fee Schedule, available at [https://usequities.nyx.com/sites/usequities.nyx.com/files/nyse\\_arca\\_marketplace\\_fees\\_3\\_01\\_12\\_.pdf](https://usequities.nyx.com/sites/usequities.nyx.com/files/nyse_arca_marketplace_fees_3_01_12_.pdf).

<sup>9</sup> Market share is the percentage of CADV traded on NYSE Arca. Participation rate is the percentage of NYSE Arca volume traded by the LMM. Make ratio is the percentage of LMM volume that provides liquidity. Take ratio is the percentage of

LMM volume that takes liquidity. The formula for calculating the transaction credit is as follows: (LMM make volume \* Make Rate) + (LMM take volume \* Take Rate). LMM make volume equals CADV \* NYSE Arca market share \* LMM participation rate \* LMM make ratio. LMM take volume equals CADV \* NYSE Arca market share \* LMM participation rate \* LMM take ratio.

<sup>10</sup> The Exchange would provide notification on its Web site regarding the ETPs participating in the Fixed Incentive Program and the assigned LMMs.

Fixed Incentive Program. Eligible products would include any ETP that is listed on the Exchange as of the commencement of the pilot period or that becomes listed during the pilot period, and the listing is under NYSE Arca Equities Rules 5.2(j)(3) (Investment Company Units), 5.2(j)(5) (Equity Gold Shares), 5.2(j)(6) (Equity Index-Linked Securities, Commodity-Linked Securities, Currency-Linked Securities, Fixed Income Index-Linked Securities, Futures-Linked Securities, and Multifactor Index-Linked Securities), 8.100 (Portfolio Depository Receipts), 8.200 (Trust Issued Receipts), 8.201 (Commodity-Based Trust Shares), 8.202 (Currency Trust Shares), 8.203 (Commodity Index Trust Shares), 8.204 (Commodity Futures Trust Shares), 8.300 (Partnership Units), 8.600 (Managed Fund Shares), and 8.700 (Managed Trust Securities).

Proposed NYSE Arca Equities Rule 8.800(b)(1) would describe the issuer's application process. An issuer that wishes to have an ETP participate in the Fixed Incentive Program and pay the Exchange an Optional Incentive Fee would be required to submit a written application in a form prescribed by the Exchange for each ETP. The issuer could elect to participate at the time of listing or thereafter at the beginning of each quarter during the pilot period. An issuer could not have more than five existing ETPs, that are listed on the Exchange prior to pilot [sic], participate in the Fixed Incentive Program. The Exchange would communicate the ETP(s) proposed for inclusion in the Fixed Incentive Program on a written solicitation that would be sent to all qualified LMM firms<sup>11</sup> along with the Optional Incentive Fee the issuer proposes to pay the Exchange for each ETP. The permitted range for the Optional Incentive Fee would be set forth in the Exchange's Fee Schedule. The issuer and the LMM thereafter would agree upon the final Optional Incentive Fee for each ETP. If more than one qualified LMM proposed to serve as such, the issuer would choose the LMM.

Proposed NYSE Arca Equities Rule 8.800(b)(2) would set forth eligibility requirements for issuers' participation in the Fixed Incentive Program. To be eligible to participate in the Fixed Incentive Program, an issuer would be

required to be current in all payments due to the Exchange if it had other securities listed on the Exchange. In addition, the issuer would be required to be current in all payments due to the Exchange and compliant with continuing listing standards for the ETP proposed for inclusion if the issuer elected to participate in the Fixed Incentive Program after listing such ETP on the Exchange.

Proposed NYSE Arca Equities Rule 8.800(c) would describe the process for the payment of the Optional Incentive Fee for each ETP. The Optional Incentive Fee would be paid by the issuer to the Exchange in quarterly installments for each participating ETP at the beginning of each quarter and prorated if the issuer commences participation for an ETP in the Fixed Incentive Program after the beginning of a quarter. The issuer would receive a prorated credit from the Exchange following the end of the quarter if the LMM did not meet its minimum performance standards for an ETP in any given month in such quarter. The credit would be applied against the issuer's next quarterly installment of the Optional Incentive Fee for the ETP, or otherwise credited or refunded to the issuer if the ETP was withdrawn from the Fixed Incentive Program. If an issuer did not pay its quarterly installments to the Exchange on time and the ETP continued to be listed, the Exchange would continue to credit the LMM as described in proposed Rule 8.800(d) below, except that after two quarters, if an issuer was not current in its quarterly installments for an ETP, such ETP would be automatically terminated from the Fixed Incentive Program.

Proposed NYSE Arca Equities Rule 8.800(d) would describe the LMM Payments by the Exchange. Under this provision, the Exchange would credit an LMM for the LMM Payment, which would be equal to the Optional Incentive Fee paid by the issuer, less an Exchange administration fee set forth in the Fee Schedule.<sup>12</sup> An LMM that receives an LMM Payment would not be eligible for LMM Rates for such ETP under the Exchange's Fee Schedule while participating in the Fixed Incentive Program but would instead be subject to Standard Rates.<sup>13</sup>

The Exchange would credit an LMM for the LMM Payment at the end of each quarter. If an LMM did not meet or exceed its minimum performance standards for the ETP for a particular month, then the LMM Payment would

be prorated accordingly. As noted above, the issuer in turn would receive a prorated credit that could be used toward the following quarterly LMM Payment for that particular ETP or others that they have elected to participate in the Fixed Incentive Program. As is the case with all liquidity-adding credits currently payable to NYSE Arca members, LMM Payments would be paid directly by the Exchange from its general revenues.

Proposed NYSE Arca Equities Rule 8.800(e) would describe the circumstances for withdrawal from the Fixed Incentive Program and a reallocation process. If an ETP no longer met continuing listing standards or is being liquidated, it would be automatically withdrawn from the Fixed Incentive Program as of the ETP suspension date. In addition, NYSE Arca, in its discretion, could allow an issuer to withdraw an ETP from the Fixed Incentive Program before the end of the pilot if the assigned LMM was unable to meet its minimum performance standards for any two of the three months of a quarter or five months during the pilot and no other qualified ETP Holder was able to take over the assignment.

An LMM also could withdraw from all of its ETP assignments in the Fixed Incentive Program. Alternatively, NYSE Arca, in its discretion, could allow an LMM to withdraw from a particular ETP before the end of the pilot period if the Exchange determined that there were extraneous circumstances that prevented the LMM from meeting its minimum performance standards for such ETP that did not affect its other ETP assignments in the Fixed Incentive Program. In either such event, the LMM's ETP(s) would be reallocated as described below.

If an LMM, for a particular ETP, did not meet or exceed its minimum performance standards for any two of the three months of a quarter or five months during the pilot, or chose to withdraw from the Fixed Incentive Program, and at least one other qualified Market Maker agreed to become the assigned LMM under the Fixed Incentive Program, then the ETP would be reallocated via the written solicitation process described above. The issuer could select another LMM and renegotiate the Optional Incentive Fee. The reallocation process would be completed no sooner than the end of the current quarter and no later than the end of the following quarter.

The proposed LMM Payment is designed to encourage additional Market Makers to pursue LMM assignments and thereby support the

<sup>11</sup> The written solicitation would be included in the Green Sheet, which is the common term for an email communication sent by NYSE Arca staff members to all qualified LMMs prior to an LMM selection. The Green Sheet includes, among other things, the name, symbol, and description of the ETP(s) as well as the name of the issuer and a link to the ETP prospectus. A qualified LMM must complete the application for a specific ETP or group of ETPs.

<sup>12</sup> As noted below, the Exchange proposes that the initial administration fee be 5%.

<sup>13</sup> See *supra* note 8.

provision of consistent liquidity in ETPs listed on the Exchange. The Exchange would administer all aspects of the LMM Payments and believes that providing a quarterly LMM Payment would create a more equitable system of incentives for LMMs. The Exchange notes that the proposal would not alter the current requirements and obligations of LMMs under Exchange rules or any policies and procedures related to LMMs.<sup>14</sup>

#### Implementation of Fixed Incentive Program

The pilot program would be offered to issuers from the date of implementation, which would occur no later than 90 days after the effective date of this filing, until December 31, 2013. As referenced above, each issuer could select ETPs to participate in the Fixed Incentive Program. During the course of the pilot period, the Exchange would assess the Fixed Incentive Program and may expand the criteria for ETPs that are eligible to participate for example, to permit issuers to include more than five ETPs that were listed on the Exchange before the pilot. At the end of the pilot, the Exchange would determine whether to continue or discontinue the pilot or make it permanent and submit a rule filing as necessary. If the Exchange determines to change the terms of the pilot while it is ongoing, it would submit a rule filing to the Commission.

During the pilot program, the Exchange would provide the Commission with certain market quality data on a confidential basis each month. Such data would include, for all ETPs listed as of the date of implementation of the pilot program and listed during the pilot (for comparative purposes), volume (CADV and NYSE Arca ADV), NBBO bid/ask spread differentials, LMM participation rates, NYSE Arca market share, LMM time spent at the inside, LMM time spent within \$0.03 of the inside, percent of time NYSE Arca has the best price with the best size, LMM quoted spread, LMM quoted depth, and Rule 605 statistics (one-month delay) as agreed upon by the Exchange and the Commission staff. In connection with this proposal, the Exchange would provide such data as may be periodically requested by the Commission.

#### Amendments to Listing Fee Schedule and Trading Fee Schedule

To implement the pilot, the Exchange also proposes to amend its Listing Fee Schedule to provide that the Optional Incentive Fee under NYSE Arca Rule

8.800 may range from \$10,000 to \$40,000 and to amend its Trading Fee Schedule to provide that at the end of each quarter, the Exchange would credit the LMM assigned to an ETP the Optional Incentive Fee, less a 5% Exchange administration fee, and that an LMM that receives an LMM Payment under NYSE Arca Rule 8.800 would be subject to Standard Rates rather than LMM Rates.

#### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>15</sup> in general, and Sections 6(b)(4) and 6(b)(5) of the Act,<sup>16</sup> in particular.

The Exchange believes that the proposed rule change is consistent with Section 6(b)(4) of the Act in that it is designed to provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities and that it is not unfairly discriminatory. The Exchange believes that the proposed Optional Incentive Fees for ETPs are reasonable, given the additional costs to the Exchange of providing the LMM Payment. The Exchange also believes that the proposed fees are reasonable because they would be used by the Exchange to offset, in part, the cost that the Exchange incurs to provide listing services for ETPs. These costs include, but are not limited to, ETP rulemaking initiatives, listing administration processes, issuer services, consultative legal services provided to ETP issuers in support of new product development, and administration of the proposed quarterly LMM Payment.

The Exchange believes that the Optional Incentive Fee is reasonable, equitably allocated, and not unreasonably discriminatory. The fee would be equitably allocated and not unfairly discriminatory because it is entirely voluntary on the issuer's part to join the pilot program. The amount of the fee would be determined and paid by the issuer within the \$10,000 to \$40,000 band per ETP.

The Exchange believes that the LMM Payment and standard transaction fees and credits are equitable in that any LMM could seek to participate in the program. The Exchange further believes that the range of credits is fair and equitable in light of the LMM's obligations and minimum performance standards and that it is reasonable for the Exchange to retain an administration

fee to recover the costs of administering the pilot program.

The Exchange further believes that the proposed rule change is consistent with Section 6(b)(5) of the Act in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system. In particular, the Exchange believes that creating an incentive for an ETP Holder to act as an LMM would foster cooperation and coordination with persons engaged in facilitating securities transactions and enhance the mechanism of a free and open market. The assignment of an LMM, which is held to higher minimum performance standards as compared to other market participants, helps to promote fair and orderly markets in ETPs on the Exchange.

The Exchange believes that its implementation plan and the pilot period are reasonable in that they would permit the Commission, the Exchange, LMMs, and issuers to assess the impact of the Fixed Incentive Program before making it available to all ETPs. In particular, the Exchange believes that it is beneficial and not unfairly discriminatory to limit the ETPs participating so that the Exchange and issuers could measure the experience against non-participating ETPs and thereby conserve the commitment of resources to the pilot program.

The Exchange intends to utilize its existing surveillance procedures applicable to derivative products to monitor trading in the ETPs participating in the pilot program, which the Exchange believes are adequate to properly monitor Exchange trading of the participating ETPs in all trading sessions and to deter and detect violations of Exchange rules and applicable federal securities laws.

Finally, the Exchange believes that the pilot program would not be inconsistent with Financial Industry Regulatory Authority ("FINRA") Rule 5250, which prohibits payment for market making. The Exchange believes that FINRA Rule 5250 is designed to address issues associated with securities of operating companies, and such issues are not present with ETPs, which have derivative pricing, creation and/or redemption features, or up sizing that would preclude the type of manipulation that FINRA Rule 5250 is designed to prevent. Moreover, the Exchange believes that the structure of

<sup>14</sup> See *supra* note 5.

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

<sup>16</sup> 15 U.S.C. 78f(b)(4) and (5).

its proposal is unique and has appropriate safeguards. For example, the proposal includes the interposition of the Exchange between the issuers and LMMs, the payment of fees from the general revenues of the Exchange, and the existing obligations and minimum performance standards that are monitored by the Exchange under NYSE Arca Equities Rules 7.23 and 7.24, respectively. For these reasons, the Exchange does not believe that its proposal would be inconsistent with FINRA Rule 5250.<sup>17</sup>

#### *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**

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange 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. The Commission requests comment, in particular, on the following aspects of the proposed rule change:

1. The Exchange asserts that LMMs in ETPs incur higher inventory, quoting, and other risks than other market participants on the Exchange and that

there is less value relative to risk of acting as an LMM for ETPs that exhibit low CADV. Do commenters agree that low interest levels by LMMs in ETPs that have low CADV is a result of such value/risk discrepancy? Why or why not? What other factors could contribute to a lack of interest by LMMs in such ETPs? What other factors could explain the apparent increasing proportion of new ETPs that are listed on the Exchange without a designated LMM?

2. The Exchange asserts that providing a quarterly LMM Payment to LMMs assigned to ETPs in the Fixed Incentive Program will create a more equitable system of incentives for LMMs. Do commenters believe that the Fixed Incentive Program will incentivize more LMMs to take assignments in ETPs. If so, how? If not, why not?

3. Given the inherent arbitrage link between trading ETPs and their underlying holdings, would a lack of liquidity in an ETP impact the ability of LMMs to quote relatively narrow bids and offers? What, if anything, does a lack of liquidity in an ETP indicate about the ability of an LMM or other market maker to make effective use of arbitrage and the creation/redemption mechanisms often associated with ETPs? How, if at all, would a market-making incentive program affect any intraday premium (discount) of the traded price of an ETP above (below) its intraday indicative value?

4. The Exchange states that the Fixed Incentive Program is designed to encourage additional Market Makers to pursue LMM assignments and thereby support the provision of consistent liquidity in ETPs listed on the Exchange. The Commission seeks specific commentary on any potential impact of the proposed rules on the market quality of ETPs. Do commenters agree with the Exchange that the Fixed Incentive Program would support the provision of consistent liquidity in ETPs listed on the Exchange? If so, please explain. If not, why not?

5. If two ETPs share similar market quality characteristics (quoted spread, size, volume, etc.) but one is supported by the Fixed Incentive Program and the other is not, what, if anything, does that suggest about the fundamental market qualities of the two ETPs? Would investors understand, and should they be concerned about, the differences underlying the seemingly similar market qualities of the two ETPs? Are there other aspects of this type of incentivized market quality that should concern investors? Are such apparent improvements in market quality

consistent with the Act and investor protection? Why or why not?

6. Under the proposal, LMMs for ETPs in the Fixed Incentive Program would continue to be subject to the current LMM performance standards and would not be subject to higher performance standards. Do commenters believe this is appropriate? Why or why not? Should LMMs for ETPs in the Fixed Incentive Program be subject to higher standards because of the LMM Payments that LMMs could be entitled to receive? Why or why not?

7. FINRA Rule 5250 prohibits FINRA members from directly or indirectly accepting payment from an issuer of a security for acting as a market maker. The Exchange asserts that FINRA Rule 5250 is designed to address issues associated with securities of operating companies, and such issues are not present with ETPs, because they have derivative pricing, creation and/or redemption features, or upsize that would preclude the type of manipulation that FINRA Rule 5250 is designed to prevent. Do commenters agree with this assertion? If so, why? If not, why not?

8. The Exchange notes in its filing that it expects FINRA to file a proposed rule change to amend its Rule 5250 to indicate that participation by LMMs and issuers in the Fixed Incentive Program would not be prohibited by FINRA Rule 5250. FINRA Rule 5250 (previously NASD Rule 2460) was implemented, in part, to address concerns about issuers paying market makers to improperly influence the price of an issuer's stock.<sup>18</sup> Do commenters believe the Fixed Incentive Program would raise the types of concerns that FINRA Rule 5250

<sup>18</sup> See Securities Exchange Act Release No. 38812 (July 3, 1997), 62 FR 37105 (July 10, 1997) (SR-NASD-97-29) ("Specifically, the Commission finds that the rule preserves the integrity of the marketplace by ensuring that quotations accurately reflect a broker-dealer's interest in buying or selling a security. The decision by a firm to make a market in a given security and the question of price generally are dependent on a number of factors, including, among others, supply and demand, the firm's expectations toward the market, its current inventory position, and exposure to risk and competition. This decision should not be influenced by payments to the member from issuers or promoters. Public investors expect broker-dealers' quotations to be based on the factors described above. If payments to broker-dealers by promoters and issuers were permitted, investors would not be able to ascertain which quotations in the marketplace are based on actual interest and which quotations are supported by issuers or promoters. This structure would harm investor confidence in the overall integrity of the marketplace. The Commission finds that the proposed rule supports a longstanding policy and position of the NASD and establishes a clear standard of fair practice for member firms.")

<sup>17</sup> Notwithstanding the Exchange's views, and based upon discussions with FINRA, subsequent to the Exchange's filing of this proposal FINRA will file an immediately effective rule change indicating that participation by LMMs and issuers in the Fixed Incentive Program would not be prohibited by FINRA Rule 5250.

was designed to address? Why or why not?

9. The Exchange asserts that the structure of its proposal is unique and has appropriate safeguards to dispel the concerns that FINRA Rule 5250 was designed to address. For example, the Exchange notes that the proposal includes the interposition of the Exchange between the issuers and LMMs, the payment of fees from the general revenues of the Exchange, and the existing obligations and minimum performance standards that are monitored by the Exchange under NYSE Arca Equities Rules 7.23 and 7.24, respectively. Do commenters agree that the Exchange's proposal adequately addresses the policies and concerns behind FINRA Rule 5250? Why or why not? What are commenters' views on whether, and if so, how, the Fixed Incentive Program would be consistent with the rationale behind FINRA Rule 5250?

10. Could there be conflicts of interest between an issuer of an ETP in the Fixed Incentive Program and the LMM assigned to such ETP? If so, what are those conflicts of interest?<sup>19</sup> Please explain whether the Exchange's proposal adequately addresses such potential conflicts, and if so, how, and if not, why not.

11. Are the proposed criteria for participation by potential ETP issuers and/or LMMs in the Fixed Incentive Program sufficiently clear, precise, and objective to address concerns about potential conflicts of interest between issuers and market makers? Why or why not? Should such participation standards be more objective to ensure that there is a level playing field in determining who the issuers and market makers are for a particular ETP in the Fixed Incentive Program? Would more clear and objective standards help to address conflicts of interest that may be present between issuers and market makers, if any? Under the proposed Fixed Incentive Program, if more than one qualified LMM proposes to serve as such, the issuer would choose the LMM.

<sup>19</sup> The Commission's order approving NASD Rule 2460 discussed conflicts of interest that may exist between issuers and market makers. *See id.* at 37106 ("It has been a longstanding policy and position of the NASD that a broker-dealer is prohibited from receiving compensation or other payments from an issuer for quoting, making a market in an issuer's securities or for covering the member's out-of-pocket expenses for making a market, or for submitting an application to make a market in an issuer's securities. As stated in Notice to Members 75-16 (February 20, 1975), such payments may be viewed as a conflict of interest since they may influence the member's decision as to whether to quote or make a market in a security and, thereafter, the prices that the member would quote.")

What are commenters' views on allowing the issuer that has chosen to participate in the Fixed Incentive Program to choose the LMM? Should the Exchange establish objective standards and be responsible for choosing the designated LMM for a particular issuer and ETP in the Fixed Incentive Program? Would allowing an issuer that has chosen to participate in the Fixed Incentive Program to choose its LMM for the particular ETP be consistent or inconsistent with the policies and concerns behind FINRA Rule 5250?

12. Is it appropriate and consistent with the Act to allow issuers to choose to enter into the Fixed Incentive Program and pay the Optional Incentive Fee? Why or why not? Would it be more or less appropriate to require all, or a fixed subset of, ETP issuers to enter the Fixed Incentive Program and pay the Optional Incentive Fee? What would be the impact on market maker incentives of allowing issuers to choose to enter into the Fixed Incentive Program and pay the Optional Incentive Fee?

13. Is it appropriate and consistent with the Act to allow issuers and LMMs to negotiate the Optional Incentive Fee? Why or why not? Does allowing issuers to negotiate such fees directly with LMMs raise concerns regarding investor confidence, market integrity, and member standards, similar to those discussed in connection with FINRA Rule 5250?<sup>20</sup> If so, what are those concerns? Should the Optional Incentive Fee agreed upon between the issuer and the LMM for a particular ETP be publicly disclosed? Why or why not?

14. With respect to an ETP, should the entity paying the Optional Incentive Fee be the sponsor or the fund? What impact, if any, would it have on fund investors if the fund pays the Optional Incentive Fee as opposed to the sponsor? Are the proposed rules sufficiently clear as to which entity will be paying the Optional Incentive Fee?

15. Section 11(d)(1) of the Act generally prohibits a firm that is both a broker and a dealer in securities from extending or maintaining any credit on any new issue security if the broker-dealer participated in the distribution of the new issue security within the preceding 30 days. The Commission has granted relief to authorized participants from these restrictions if, among other things, neither the broker-dealer authorized participant, nor any natural person associated with such broker-dealer authorized participant, directly or indirectly, receives from the fund complex any payment, compensation, or

<sup>20</sup> *See supra* note 18.

other economic incentive to promote or sell the shares of the fund to persons outside the fund complex, other than non-cash compensation permitted under NASD Rule 2380. Should authorized participants participating in the creation and redemption of shares of ETPs that are also LMMs in those same ETPs be eligible to receive LMM Payments? Would the LMM Payments give these authorized participants economic incentives to promote or sell shares of the ETP? Should such payments be viewed by the Commission as coming directly or indirectly from the fund complex of the ETP? Should LMM Payments disqualify broker-dealer authorized participants from relying on the Commission's exemption from Section 11(d)(1) of the Act?

16. Could the Fixed Incentive Program have an impact (either positive or negative) on incentives for market making in other ETPs listed and traded on the Exchange that are not eligible for and/or do not participate in the Fixed Incentive Program, either because the Exchange has limited the number of ETPs that an issuer may have in the program, the issuer does not qualify for the program, or the issuer's application for participation is otherwise denied? If so, what type of impact, and why? If not, why not? Please explain.

17. The Exchange's stated rationale for the Fixed Incentive Program is that market makers need additional incentives to take on LMM assignments in ETPs with low CADV. However, the Fixed Incentive Program does not limit which ETPs can be included within the program based on trading volume, and does not provide for the removal or withdrawal of an ETP from the program if such ETP reaches a certain CADV level. Would it be more appropriate for an ETP to be removed from the Program once it reaches a certain liquidity level or volume threshold? Why or why not? If so, what would be an appropriate threshold? Would it be more appropriate to limit inclusion in the program to newly listed or low volume ETPs? Why or why not?

18. Could the Fixed Incentive Program have unintended consequences on fair and orderly markets in an ETP when such security leaves the program? If so, what could these consequences be? If not, why not? Please explain.

19. The Exchange has proposed to implement the Fixed Incentive Program on a pilot basis beginning no later than 90 days after the effective date of this filing, until December 31, 2013. Is this a reasonable amount of time to assess the impact of the proposed rules? If not, why not? Please explain.

20. What additional data, if any, should be provided by the Exchange to help assess during the pilot period whether the Fixed Incentive Program is achieving its stated goals? For example, if the Exchange required ETPs to be listed and traded outside the Fixed Incentive Program for a period of time before being eligible for the program, could such a requirement provide useful “before and after” data for ETPs to permit the Exchange and the Commission to more accurately assess the market quality of the securities before participating in the program and the market quality of the same securities while participating in the program? If so, how? If not, please explain.

21. The Exchange represents that it will provide certain public disclosures relating to the Fixed Incentive Program (i.e., notification on its Web site regarding the ETPs participating in the Fixed Incentive Program and the assigned LMMs). Do commenters believe that these disclosures would provide sufficient information to investors? If not, why not? Do commenters believe the program is sufficiently transparent? Why or why not? Is there any other information that the Exchange should provide on its Web site regarding the Fixed Incentive Program and participating ETPs, issuers, and LMMs? For example, should the Exchange be required to publish on its Web site any notices from an issuer or LMM to withdraw from the program, or notices that an issuer or LMM has been removed from the program? Should the Exchange be required to publish on its Web site the performance standards to which LMMs in the program are subject? What advantages or disadvantages would such disclosures provide? Please explain.

22. Would it be helpful to investors to have public notice of an issuer’s participation in the Fixed Incentive Program through means other than on the Exchange’s Web site, such as in the issuer’s periodic reports to the Commission, on the issuer’s Web site, or through a ticker symbol identifier on the consolidated tape? Why or why not?

23. What are commenters’ views on whether the proposed disclosures are sufficient to enable all investors, even less sophisticated investors, to understand the potential impact of the proposed Fixed Incentive Program on an ETP, including that an issuer’s participation in the program is voluntary and subject to withdrawal?

24. Should the Exchange be required to publicly (and anonymously) disclose statistics on the performance of LMMs? Would such disclosure provide meaningful information to investors

(e.g., would such disclosure provide investors the opportunity to assess how much perceived liquidity is being provided by LMMs in the Fixed Incentive Program, as opposed to liquidity provided by market makers and other market participants who are not paid an LMM Payment)? If so, what information should be disclosed and why? If not, why not? What advantages or disadvantages would such disclosure provide? Please explain.

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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR–NYSEArca–2012–37 on the subject line.

#### *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–2012–37. This file number should be included on the subject line if email 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 Web site (<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 Web site viewing and printing in the Commission’s Public Reference Section, 100 F Street NE., Washington, DC 20549–1090, on official business days between 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the NYSE’s principal office and on its Internet Web site at [www.nyse.com](http://www.nyse.com). 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–2012–37 and

should be submitted on or before June 7, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>21</sup>

**Kevin M. O’Neill,**  
*Deputy Secretary.*

[FR Doc. 2012–11914 Filed 5–16–12; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–66968; File No. SR–Phlx–2012–57]

### Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Complex Order Fees for Removing Liquidity in Select Symbols

May 11, 2012.

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 30, 2012, NASDAQ OMX PHLX LLC (“Phlx” or “Exchange”) 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 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 Section I of the Exchange’s Pricing Schedule entitled “Rebates and Fees for Adding and Removing Liquidity in Select Symbols.” The Exchange previously filed an immediately effective rule change, SR–Phlx–2012–27,<sup>3</sup> to amend certain fees and rebates in Section I, which filing was temporarily suspended by the Commission as of April 30, 2012 (“Suspension Order”).<sup>4</sup> At this time, to continue the effectiveness of certain fees and rebates that were contained in SR–Phlx–2012–27, the Exchange is filing this rule

<sup>21</sup> 17 CFR 200.30–3(a)(12).

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

<sup>2</sup> 17 CFR 240.19b–4.

<sup>3</sup> See Securities Exchange Act Release No. 66551 (March 9, 2012), 77 FR 15400 (March 15, 2012) (SR–Phlx–2012–27).

<sup>4</sup> By order dated April 30, 2012, the Commission suspended SR–Phlx–2012–27 and SR–Phlx–2012–54. See Securities Exchange Release No. 66884 (April 30, 2012).