

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-78987; File No. SR-NSX-2016-13]

### Self-Regulatory Organizations; National Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend Exchange Rules 11.11 and 11.26 To Describe Changes to System Functionality Necessary To Implement the Regulation NMS Plan To Implement a Tick Size Pilot Program

September 29, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on September 26, 2016, National Stock Exchange, Inc. (“NSX” or the “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change, as described in Items I and II, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comment 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 is proposing to: (1) Amend Exchange Rule 11.11(c), Other Types of Orders and Order Modifiers, to specify that certain order types will not be supported upon the effective date of the Regulation NMS Plan to Implement a Tick Size Pilot (the “Plan”)<sup>3</sup> and (2) amend Exchange Rule 11.26 to specify that the Exchange will not to support the Block Size Order Exemption to the Trade-at rule for Test Group Three securities. The Exchange is proposing this rule change after carefully considering the scope of the changes to the Exchange’s trading system (“System”)<sup>4</sup> to support the functionality requirements for Test Group Three securities and the potential for introducing additional systemic risk.

The Exchange has designated this proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>5</sup> and

provided the Commission with the notice required by Rule 19b-4(f)(6)(iii) under the Act.<sup>6</sup>

The text of the proposed rule change is available on the Exchange’s Web site at <http://www.nsx.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 Exchange 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 these 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

On August 25, 2014, NYSE Group, Inc., on behalf of BZX, Chicago Stock Exchange, Inc., Bats EDGA Exchange, Inc., Bats EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc. (“FINRA”), NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, the Nasdaq Stock Market LLC, New York Stock Exchange LLC (“NYSE”), NYSE MKT LLC, and NYSE Arca, Inc. (collectively “Participants”), filed with the Commission, pursuant to Section 11A of the Act<sup>7</sup> and Rule 608 of Regulation NMS thereunder,<sup>8</sup> the Plan to Implement a Tick Size Pilot Program (“Pilot”).<sup>9</sup> The Participants filed the Plan to comply with an order issued by the Commission on June 24, 2014.<sup>10</sup> The Plan<sup>11</sup> was published for comment in the **Federal Register** on November 7, 2014 and was thereafter approved by the Commission, as modified, on May 6, 2015.<sup>12</sup> On November 6, 2015, the Commission granted the Participants an exemption

from implementing the Plan until October 3, 2016.<sup>13</sup> On March 3, 2016, the Commission noticed an amendment to the Plan adding NSX as a Participant.<sup>14</sup>

The Plan is designed to allow the Commission, market participants, and the public to study and assess the impact of increment conventions on the liquidity and trading of the common stocks of small-capitalization companies. Each Participant is required to comply, and to enforce compliance by its member organizations, as applicable, with the provisions of the Plan. As is described more fully below, the proposed rules would require ETP Holders<sup>15</sup> to comply with the applicable data collection requirements of the Plan.<sup>16</sup>

The Pilot will include stocks of companies with \$3 billion or less in market capitalization, an average daily trading volume of one million shares or less, and a volume weighted average price of at least \$2.00 for every trading day. The Pilot will consist of a control group of approximately 1,400 Pilot Securities and three test groups with 400 Pilot Securities in each (selected by a stratified random sampling process).<sup>17</sup> During the pilot, Pilot Securities in the control group will be quoted at the current tick size increment of \$0.01 per share and will trade at the currently permitted increments. Pilot Securities in the first test group (“Test Group One”) will be quoted in \$0.05 minimum increments but will continue to trade at any price increment that is currently permitted.<sup>18</sup> Pilot Securities in the second test group (“Test Group Two”) will be quoted in \$0.05 minimum increments and will trade at \$0.05 minimum increments subject to a midpoint exception, a retail investor order exception, and a negotiated trade

<sup>13</sup> See Securities Exchange Act Release No. 76382 (November 6, 2015), 80 FR 70284 (November 13, 2015) (File No. 4-657) (Order Granting Exemption From Compliance With the National Market System Plan To Implement a Tick Size Pilot Program).

<sup>14</sup> See Securities Exchange Act Release No. 77277 (March 3, 2016), 81 FR 12162 (March 8, 2016).

<sup>15</sup> An “ETP Holder” is a registrant of NSX to which NSX has issued an ETP. An “ETP” is defined as “. . . an Equity Trading Permit issued by the Exchange for effecting approved securities transactions on the Exchange’s trading facilities. . . .” See Exchange Rule 1.5.E(1).

<sup>16</sup> Rule 11.26, Interpretations and Policies .11, which is being renumbered to .12, provides that the Rule shall be in effect during a pilot period to coincide with the pilot period for the Plan (including any extensions to the pilot period for the Plan).

<sup>17</sup> See Section V of the Plan for identification of Pilot Securities, including criteria for selection and grouping.

<sup>18</sup> See Section VI(B) of the Plan.

<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. 72460 (June 24, 2014), 79 FR 36840 (June 30, 2014).

<sup>4</sup> Under Exchange Rule 1.5S.(4) [sic], the term “System” is defined as the electronic securities communications and trading facility designated by the Board of Directors of the Exchange through which the orders of Users are consolidated for ranking and execution.

<sup>5</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>6</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>7</sup> 15 U.S.C. 78k-1.

<sup>8</sup> 17 CFR 242.608.

<sup>9</sup> See Letter from Brendon J. Weiss, Vice President, Intercontinental Exchange, Inc., to Secretary, Commission, dated August 25, 2014.

<sup>10</sup> See note 3, *supra*.

<sup>11</sup> Unless otherwise specified, capitalized terms used in this filing are based on the defined terms of the Plan.

<sup>12</sup> See Securities Exchange Act Release No. 74892 (May 6, 2015), 80 FR 27513 (May 13, 2015) (File No. 4-657) (“Approval Order”).

exception.<sup>19</sup> Pilot Securities in the third test group (“Test Group Three”) will be subject to the same quoting and trading increments as Test Group Two and also will be subject to the “Trade-at” requirement to prevent price matching by a market participant that is not displaying at a Trading Center’s “Best Protected Bid” or “Best Protected Offer,” unless an enumerated exception applies.<sup>20</sup> In addition to the exceptions provided under Test Group Two, an exception for Block Size orders and exceptions that mirror those under Rule 611 of Regulation NMS<sup>21</sup> will apply to the Trade-at requirement.

In approving the Plan, the Commission noted that the Trading Center data reporting requirements would facilitate an analysis of the effects of the Pilot on liquidity (*e.g.*, transaction costs by order size), execution quality (*e.g.*, speed of order executions), market maker activity, competition between trading venues (*e.g.*, routing frequency of market orders), transparency (*e.g.*, choice between displayed and hidden orders), and market dynamics (*e.g.*, rates and speed of order cancellations).<sup>22</sup>

#### Proposed Amendments to Rule 11.11, Order Types and Modifiers

The Exchange proposes to amend NSX Rule 11.11(c) to specify that, upon the Plan’s effective date, certain order types will not be supported for trading across all symbols and will be rejected upon entry into the System. The Exchange is making this proposal to avoid creating unnecessary System complexity and introducing unnecessary systemic risk to the System, as well as to avoid expending resources unnecessarily in order to support order types that are of limited current usage. Pursuant to Rule 1001(a) of Regulation Systems Compliance and Integrity (“Regulation SCI”),<sup>23</sup> the Exchange is required to “. . . establish, maintain and enforce written policies and procedures reasonably designed to ensure that its SCI systems, and for the purposes of security standards, indirect SCI systems, have levels of capacity, integrity, resiliency and security adequate to maintain [its] operational capability and promote the maintenance of fair and orderly markets.” The Exchange is proposing the instant rule change in order to assure that it will maintain the operational capability of the System and assure that the System

will be ready to operate under Plan requirements as of its effective date, October 3, 2016.

The Exchange has determined to reject all incoming Sweep Orders and Destination Specific Orders in all symbols. The Exchange is proposing this approach, instead of one in which it would only reject any such orders entered in the Plan securities, in order to avoid data anomalies that could result if the Exchange were to reject only Sweep Orders and Destination Specific Orders in the Pilot securities, but continue to allow them in non-Pilot symbols.

#### Sweep Orders

The Exchange proposes to amend Rule 11.11(c)(7) to state that upon the effective date of the Plan, described in Rule 11.26,<sup>24</sup> the Exchange will reject all Sweep Orders entered into the System. A Sweep Order is a limit order that instructs the System to “sweep” the market. Sweep Orders may be designated as “Protected Sweep,” “Full Sweep,” or “Destination Sweep.” An order designated as a Protected Sweep Order is converted into one or more limit orders with sizes equal to the order sizes in the NSX Book and the order sizes of protected quotations at away trading centers to be executed in accordance with Exchange Rule 11.15(b).<sup>25</sup> An order designated as a Full Sweep Order is converted into one or more limit orders with sizes equal to the sizes of the best available quotations (including manual quotations) in the NSX Book and at away trading centers in accordance with Exchange Rule 11.15(b). An order designated as a Destination Sweep Order is routed to an away trading center specified by the User, after the order is exposed to the NSX Book.

The System changes and testing necessary for handling a Sweep Order to comply with the Trade-at requirements for Test Group Three securities under the Plan are complex and will create unnecessary risk to the System relative to ETP Holders’ current usage of the order type. The Exchange would be required to dedicate significant resources to changing the System to ensure that Sweep Orders are handled in compliance with the Trade-at prohibition of Test Group Three, even though the Exchange has received only one Sweep Order since it resumed

trading operations in December 2015.<sup>26</sup> The Exchange believes that this extremely limited usage of Sweep Orders does not justify creating additional System complexity and introducing the inherent risk to the System in creating such complexity by supporting these order types. The Exchange has determined that the scope of programming and testing to assure that Sweep Orders would execute and route consistent with the requirements of the Plan does not justify the level of potential risk involved, especially in view of the October 3, 2016 Plan implementation date. As a result of these factors, the Exchange proposes to reject all Sweep Orders entered into the System for all securities traded on the Exchange.

#### Destination Specific Orders

The Exchange proposes to amend Rule 11.26(c)(7) [sic] to specify that upon the effective date of the Plan, described in NSX Rule 11.26, the Exchange will reject all Destination Specific Orders entered into the System. A Destination Specific Order is a market or limit order that instructs the System to route the order to a specified away trading center, after exposing the order to the NSX Book. Users can access markets offering bids and offers other than protected quotations (*i.e.*, manual quotations) by entering a Destination Specific Order. The System changes necessary for handling of a Destination Specific Order to comply with the Trade-at provision of the Plan become increasingly complex and introduce unnecessary risk relative to ETP Holders’ usage of the order type. For example, in a Test Group Three security, which is subject to the Trade-at Prohibition, the Exchange would not be able to follow the customer’s instruction to route the order to a specific destination if another trading center was displaying a protected quotation at the Trade-at price, and the order would have to be canceled. The Exchange would be required to dedicate significant resources to programming the System to ensure that Destination Specific Orders are handled in compliance with the Trade-at prohibition of Test Group Three, even though the Exchange has not received a single Destination Specific Order since resuming trading operations in

<sup>19</sup> See Section VI(C) of the Plan.

<sup>20</sup> See Section VI(D) of the Plan.

<sup>21</sup> 17 CFR 242.611.

<sup>22</sup> See Approval Order, 80 FR at 27543.

<sup>23</sup> 17 CFR 242.1001(a).

<sup>24</sup> NSX Rule 11.26 governs the Exchange’s data collection and quoting and trading requirements under the Plan.

<sup>25</sup> Exchange Rule 11.15(b) pertains to order handling and execution of Sweep Orders.

<sup>26</sup> See Exchange Act Release No. 76640 (December 14, 2015), 80 FR 79122 (December 18, 2015), Order Approving a Proposed Rule Change to Modify and Eliminate Certain Rules and to Enable Trading Activity to Resume on the Exchange. Trading operations resumed on December 22, 2015 and since that time, the Exchange has received one Sweep Order.

December 2015. The Exchange believes that current non-usage of Destination Specific Orders does not justify using extensive resources to create additional System complexity by supporting the Destination Specific Order type for Pilot securities. As a result of these factors, the Exchange proposes to not accept all Destination Specific Orders entered into the System.

#### Block Size Order Exemption

The Exchange is further proposing to renumber Exchange Rule 11.26, Interpretations and Policies .11 to Interpretations and Policies .12 and to adopt new Interpretations and Policies .11 to specify that the Exchange will not support the Block Size Order Exemption to the Trade-at rule for Test Group Three securities. Pursuant to the Plan, the Exchange adopted Rule 11.26(c)(3)(d)(iii)c. [sic] to provide for the Block Size Order Exemption, which allows an ETP Holder to execute a block size order (*i.e.*, an order of 5,000 shares or for a quantity of stock having a market value of at least \$100,000) against undisplaced liquidity in Test Group Three securities at the Trade-at price. The Exemption was included in the Plan to allow customers to completely fill their large orders at a single venue, thereby avoiding the time and cost associated with filling a block size order through many smaller orders routed to other execution venues. The Exchange has determined that, because of the programming required to implement the exemption, it will not support the exemption and will handle a block size order in a Test Group Three security as the Exchange would handle any other order not subject to exemption. Thus, block size orders in Test Group Three securities entered on NSX will be subject to the Trade-at prohibition, unless the order qualifies for one of the other exemptions under the rule.

The Exchange will not support the Block Size Order Exemption because block size orders are generally not applicable to the order types that the Exchange supports and, as such, the Exchange has rarely received block size orders. The Exchange has determined that the System changes necessary to exempt a block size order from complying with the Trade-at provision of the Plan are complex and will introduce unnecessary risk relative to ETP Holders' usage of block size orders on the Exchange.

The Exchange does not believe that market participants will be harmed in any way as a result of this determination because they can enter block-size orders in Test Group 3 securities on another

exchanges for execution. The Exchange will provide notice to all of its ETP Holders that it will not support the Block Size Order Exemption for Test Group Three securities. Further, since the Exchange rarely receives block-size orders at present, there is minimal risk that the data it produces under the Plan will be affected by the absence of information relating to the Block Size Order Exemption.

#### 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>27</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>28</sup> in particular, in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, 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 Plan requires the Exchange to establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with applicable quoting and trading requirements specified in the Plan. The proposed rule change is designed to comply with the Plan, reduce complexity, and enhance System resiliency while not adversely affecting the data collected under the Plan. Therefore, the Exchange believes that the proposed rule changes are reasonably designed to comply with applicable quoting and trading requirements specified in the Plan and, as discussed further below, other applicable regulations.

The Exchange believes that this proposal is consistent with the Act because it is designed to assist the Exchange in meeting its regulatory obligations pursuant to the Plan by allowing the Exchange to dedicate its resources to adjusting System functionalities that are consistently used by the Exchange and are impacted under the Plan. In approving the Plan, the Commission noted that the Pilot was an appropriate, data-driven test that was designed to evaluate the impact of a wider tick size on trading, liquidity, and the market quality of securities of smaller capitalization companies, and was therefore in furtherance of the purposes of the Act. The Exchange believes that this proposal is in furtherance of the objectives of the Plan, as identified by the Commission, and is therefore consistent with the Act

<sup>27</sup> 15 U.S.C. 78f(b).

<sup>28</sup> 15 U.S.C. 78f(b)(5).

because the proposal allows the Exchange to further dedicate its resources to System changes that are in furtherance of compliance with the Plan.

The Exchange also believes that its proposed amendments are consistent with the Act because they are intended to eliminate unnecessary System complexity and risk based on the de minimis current usage of such order types and sizes in Pilot Securities under the Plan's minimum trading and quoting increments or the Trade-at Prohibition. The Commission adopted Regulation SCI in November 2014 to strengthen the technology infrastructure of the U.S. securities markets.<sup>29</sup> Regulation SCI is designed to reduce the occurrence of system issues, improve resiliency when system problems do occur, and enhance the Commission's oversight and enforcement of securities market technology infrastructure.

Regulation SCI requires the Exchange to establish written policies and procedures reasonably designed to ensure that their systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain their operational capability and promote the maintenance of fair and orderly markets, and that they operate in a manner that complies with the Exchange Act. Each of these proposed changes are intended to reduce complexity and risk in the System to ensure the Exchange's technology remains resilient. In determining the scope of the proposed changes, the Exchange carefully weighed the impact on the Pilot, System complexity, and the usage of such order types and block size orders in Pilot Securities.<sup>30</sup> The potential complexity results from code changes for a majority of the Exchange's order types, which requires the implementation and testing of a separate branch of code for each Test Group. Development work for the Tick Pilot results in the creation of four additional branches of code that are to be developed and tested (*e.g.*, Control Group and three Test Groups). Given these complexities, the Exchange determined that the changes proposed herein are necessary to ensure continued System resiliency in accordance with the requirements of Regulation SCI. Therefore, the Exchange believes the proposed rule change

<sup>29</sup> See Securities Exchange Act Release No. 73639 (November 19, 2014), 79 FR 72251 (December 5, 2014) ("Regulation SCI Approval Order").

<sup>30</sup> But for the Plan, the Exchange notes that it would not have proposed to amend the operation of Sweep Orders and Destination Specific Orders, as well as not support the Block Size Order Exemption, as described herein.

promotes just and equitable principles of trade, removes impediments to and perfects the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

In addition, each of these proposed changes would have no impact on the data reported pursuant to the Plan. As evidenced above, Sweep Orders and Destination Specific Orders, and block size orders have rarely been used since the Exchange resumed trading operations. The limited usage and execution scenarios do not justify the additional system complexity which would be created by modifying the System to support such order types and support the Block Size Order Exemption in order to comply with the Plan. Therefore, the Exchange believes each proposed change is a reasonable means to assure the System's integrity, resiliency, and availability are such that they will continue to promote the maintenance of fair and orderly markets. Due to the additional complexity and limited usage, the Exchange believes it is not unfairly discriminatory to apply the changes proposed herein as such changes are necessary to reduce complexity and ensure continued System resiliency in accordance with the requirements of Regulation SCI. Moreover, since the Exchange is proposing to reject all Sweep Orders and Destination Specific Orders, and not just those in Pilot securities or on a test group-specific basis, there is no potential that the data compiled and submitted by the Exchange pursuant to the Plan will be affected by disparate standards applied to Plan securities.

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

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange notes that the proposed rule change is designed to assist the Exchange in meeting its regulatory obligations pursuant to the Plan, reduce System complexity, and enhance resiliency. The Exchange also notes that the proposed rule change will apply equally to all such ETP Holders, as will the data collection requirements for Market Makers.

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

The Exchange has neither solicited nor received comments on the proposed rule change.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)<sup>31</sup> of the Act and Rule 19b-4(f)(6)<sup>32</sup> thereunder because the proposal does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) by its terms, become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest.

A proposed rule change filed under Rule 19b-4(f)(6)<sup>33</sup> normally does not become operative prior to 30 days after the date of the filing. However, pursuant to Rule 19b-4(f)(6)(iii),<sup>34</sup> the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that so that the proposed rule change can become operative on September 26, 2016.

The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because it will allow the Exchange to implement the proposed rules immediately thereby preventing delays in the implementation of the Plan. The Commission notes that the Plan is scheduled to start on October 3, 2016. Therefore, the Commission hereby waives the 30-day operative delay and designates the proposed rule change to be operative upon filing with the Commission.<sup>35</sup>

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule

<sup>31</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>32</sup> 17 CFR 240.19b-4(f)(6).

<sup>33</sup> 17 CFR 240.19b-4(f)(6).

<sup>34</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>35</sup> For purposes only of waiving the operative delay for this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NSX-2016-13 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 No. SR-NSX-2016-13. This file number should be included in the subject line if email is used. To help the Commission process and review 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 Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. eastern time. Copies of such filings will also 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-NSX-2016-13 and should be submitted on or before October 26, 2016.

For the Commission by the Division of Trading and Markets, pursuant to the delegated authority.<sup>36</sup>

**Robert W. Errett,**

*Deputy Secretary.*

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<sup>36</sup> 17 CFR 200.30-3(a)(12).