

September 3, 2013

David W. Blass
Chief Counsel and Associate Director
Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Request for Exemptive Relief from Section 11(d)(1) of the Securities Exchange Act of 1934 and Rule 11d1-2 Thereunder for Broker-Dealers Participating in the NYSE Arca Incentive Program

Dear Mr. Blass:

NYSE Arca, Inc. (“NYSE Arca” or the “Exchange”), through its wholly owned subsidiary NYSE Arca Equities, Inc. (“NYSE Arca Equities”), respectfully requests that the Securities and Exchange Commission (the “Commission”) grant an exemption from Section 11(d)(1) of the Securities Exchange Act of 1934, as amended (the “Act”),¹ and Rule 11d1-2 thereunder,² to the Exchange and certain broker-dealers that receive payments under NYSE Arca Equities Rule 8.800, which authorizes a pilot program for certain exchange-traded products (“ETPs”) listed on the Exchange, and the related provisions of the Exchange’s Trading Fee Schedule (together, the “Incentive Program”),³ subject to the conditions described below. NYSE Arca further requests that the staff of the Division of Trading and Markets (“Staff”) grant no-action relief to certain broker-dealers participating in the Incentive Program permitting them to rely on certain earlier no-action relief pertaining to the application of Section 11(d)(1) and Rule 11d1-2 thereunder to commodity-based exchange traded trusts (“CBETTs”).

In Section I below, the Exchange provides background on the Incentive Program and the application of Section 11(d)(1) and Rule 11d1-2 to it. In Section II below, the Exchange sets forth its rationale for the exemptive and no-action relief, specifically that they are necessary and appropriate in the public interest and are consistent with the protection of investors because (1) the Incentive Program is designed to enhance market quality, not to encourage “share pushing”; (2) absent exemptive and no-action relief, the Exchange may not attract a sufficient number of Lead Market Makers (“LMMs”) to participate in the Incentive Program to make it successful; (3) the exemptive and no-action relief will be limited in time and scope so its effect will be very narrow; and (4) investors will be further protected by substantial public disclosures made in connection with the Incentive Program. Finally, in Section III below, the

¹ 15 U.S.C. 78mm(a).

² 17 CFR 242.11d1-2.

³ See Securities Exchange Act Release Nos. 69335 (April 5, 2013), 78 FR 21681 (April 11, 2013) (SR-NYSEArca-2013-34) (the “Notice”) and 69706 (June 6, 2013), 78 FR 35340 (June 12, 2013) (SR-NYSEArca-2013-34) (the “Approval Order”). All references to rules hereinafter are to NYSE Arca Equities rules unless otherwise noted.

Exchange sets forth the narrow and time-limited conditions under which it proposes that the relief be granted.⁴

I. Background

A. Overview of the Incentive Program

The Incentive Program is designed to enhance the market quality for ETPs by incentivizing Market Makers to take LMM assignments in certain lower-volume ETPs. The ETPs that are eligible to participate in the Incentive Program include ETPs listed on the Exchange that have fewer than one million shares in consolidated average daily volume (“CADV”). Participation in the Incentive Program will be entirely voluntary on the part of both LMMs and issuers. The costs of the Incentive Program will be offset by charging participating issuers non-refundable “Optional Incentive Fees,” which are determined by the issuer within a range of between \$10,000 and \$40,000 per year, paid quarterly, and credited to the Exchange’s general revenues. The Exchange will credit an LMM participating in the Incentive Program with an “LMM Payment,” the amount of which is determined solely by the Exchange, as set forth in the Exchange’s Trading Fee Schedule and paid by the Exchange from its general revenues, only if the LMM meets or exceeds certain “LMM Performance Standards” set forth in Rule 8.800(c) that relate to the LMM’s quoting activity in the ETP.⁵ The Incentive Program will operate for one year as a pilot program.⁶

B. Application of Section 11(d)(1) of the Act and Rule 11d1-2 to the Incentive Program

In the Approval Order for the Incentive Program, the Commission discussed the application of Section 11(d)(1) and Rule 11d1-2 to the Incentive Program.⁷ Section 11(d)(1) generally prohibits a broker-dealer from extending or maintaining credit, or arranging for the extension or maintenance of credit, on shares

⁴ The Exchange notes that the Commission’s Division of Trading and Markets, pursuant to delegated authority, has granted an exemption from Section 11(d)(1) and Rule 11d1-2 to The NASDAQ Stock Market LLC (“NASDAQ”) related to its Market Quality Program (“MQP”). See Securities Exchange Act Release No. 69892 (June 28, 2013), 78 FR 40523 (July 5, 2013) (the “NASDAQ Exemption”). The NASDAQ MQP shares a similar purpose as the Incentive Program, although certain elements of the programs differ. The Exchange is requesting substantially the same exemptive relief as was granted to NASDAQ.

⁵ At the end of each quarter, the Exchange will credit an LMM with an LMM Payment for each month during such quarter that the LMM meets or exceeds its Incentive Program LMM Performance Standards for an assigned ETP. If an LMM does not meet or exceed the Incentive Program LMM Performance Standards for an assigned ETP for a particular month, or if the ETP is withdrawn from the Incentive Program, then the LMM Payment will be zero for such month. The amount of the LMM Payment for a particular month will not exceed one-third of the quarterly Optional Incentive Fee, less an Exchange administration fee of 5%.

⁶ The Incentive Program will be implemented no later than 90 days after its approval, which was June 6, 2013.

⁷ See Approval Order, supra note 3, at 35348.

of new issue securities, if the broker-dealer participated in the distribution of the new issue securities within the preceding 30 days. The Commission's view is that shares of open-end investment companies and unit investment trusts registered under the Investment Company Act of 1940, such as exchange traded fund ("ETF") shares, are distributed in a continuous manner, and broker-dealers that sell such securities are therefore participating in the "distribution" of a new issue for purposes of Section 11(d)(1).⁸

The Division of Trading and Markets, acting under delegated authority, granted an exemption from Section 11(d)(1) and Rule 11d1-2 thereunder for broker-dealers that have entered into an agreement with an ETF's distributor to place orders with the distributor to purchase or redeem the ETF's shares ("Broker-Dealer Authorized Participants" or "Broker-Dealer APs") (such exemption hereinafter referred to as the "SIA Exemption").⁹ The SIA Exemption allows a Broker-Dealer AP to extend or maintain credit, or arrange for the extension or maintenance of credit, to or for customers on the shares of qualifying ETFs subject to the condition that neither the Broker-Dealer AP, nor any natural person associated with the Broker-Dealer AP, directly or indirectly (including through any affiliate of the Broker-Dealer AP), receives from the fund complex any payment, compensation, or other economic incentive to promote or sell the shares of the ETF to persons outside the fund complex, other than non cash compensation permitted under NASD Rule 2830(l)(5)(A), (B), or (C). This condition is intended to eliminate special incentives that Broker-Dealer APs and their associated persons might otherwise have to "push" ETF shares, i.e., induce customers to purchase newly issued shares in return for extensions of credit.

The Incentive Program will permit certain issuers of ETPs to voluntarily incur increased listing fees payable to the Exchange. In turn, the Exchange will make LMM Payments to LMMs that meet LMM Performance Standards under Rule 8.800, and thus enhance the market quality for the participating issuers. According to the Commission, LMM Payments will be accrued for, among other things, executing purchases and sales on the Exchange,¹⁰ and thus their receipt by certain broker-dealers will

⁸ See, e.g., Securities Exchange Act Release Nos. 6726 (Feb. 8, 1962), 27 FR 1415 (Feb. 15, 1962) and 21577 (Dec. 18, 1984), 49 FR 50174 (Dec. 27, 1984).

⁹ See Letter from Catherine McGuire, Chief Counsel, Division of Trading and Markets, Securities and Exchange Commission to Securities Industry Association (Nov. 21, 2005). The SIA Exemption noted that the Commission Staff had confirmed on numerous prior occasions that it would not recommend enforcement action under Section 11(d)(1) to the Commission against broker-dealers that are not Broker-Dealer APs in a particular ETF, but that effect transactions in shares of such ETF exclusively in the secondary market ("Non-AP Broker-Dealers"), and extend or maintain or arrange for the extension or maintenance of credit to or for customers on such ETF shares in connection with such secondary market transactions, as long as such Non-AP Broker-Dealers met such condition too.

¹⁰ Although the Approval Order stated that incentive payments will accrue for, among other things, executing purchases and sales on the Exchange, the Exchange respectfully notes that in contrast to the NASDAQ MQP, incentive payments will not accrue for executing purchases and sales on the Exchange, rather only for quoting activity. Under Rule 7.24, LMMs that are not participating in the Incentive Program are subject to minimum performance standards that include percentage of executions that are better than the National Best Bid ("NBB") or National Best Offer ("NBO") (collectively, "NBBO"). However,

implicate the conditions of the SIA Exemption from the new issue lending restriction in Section 11(d)(1) discussed above. The Commission's view is that LMM Payments are indirect payments from the fund complex to the Market Maker and that those payments are compensation to promote or sell the shares of the ETP. Therefore, a Market Maker that is also a broker-dealer receiving the incentives will not be able to rely on the SIA Exemption from Section 11(d)(1). This does not mean that broker-dealers cannot participate in the Incentive Program; it merely means that they cannot rely on the SIA Exemption while doing so. Thus, broker-dealers that participate in the Incentive Program will need to comply with Section 11(d)(1) unless there is another applicable exemption. As such, the Exchange is requesting that the Commission grant such an exemption.

The Approval Order also discussed the application of Section 11(d)(1) and Rule 11d1-2 thereunder to CBETTs.¹¹ The Staff has provided no-action relief from Section 11(d)(1) for certain broker-dealers transacting in CBETTs.¹² Specifically, the CBETT No-Action Relief permits Non-AP Broker-Dealers (other than the distributor) that do not create or redeem CBETT shares but engage in both proprietary and customer transactions in CBETT shares exclusively in the secondary market to extend or maintain or arrange for the extension or maintenance of credit on CBETT shares in connection with such secondary market transactions notwithstanding the general prohibition on new issue credit of Section 11(d)(1) of the Act. The CBETT No-Action Relief further permits a Broker-Dealer AP to extend or maintain or arrange for the extension or maintenance of credit on CBETT shares (other than any CBETT shares acquired by such Broker-Dealer AP as part of a basket during the initial offering period for which the Broker-Dealer AP receives an upfront selling commission) in reliance on the SIA Exemption. In each case, the CBETT No-Action Relief is conditioned on, among other things, the broker-dealer and any natural person associated with the broker-dealer not receiving from the fund complex, directly or indirectly, any payment, compensation or other economic incentive to promote or sell the CBETT's securities to persons outside of the fund complex, other than non-cash compensation permitted under NASD Rule 2830(1)(5)(A), (B), or (C). This condition is fundamentally the same as the SIA Exemption's condition for ETFs.

Rule 7.24 does not apply to LMMs in the Incentive Program, which are instead subject to Rule 7.23 and the specific performance standards under Rule 8.800(c), which relate only to quoting. See Notice, supra note 3, at 21862 n.8, and Section II.A, infra. In contrast, 25% of the credit provided to market makers under the NASDAQ MQP is attributable to sales, with the remainder attributable to purchases and quotes. See NASDAQ Exemption, supra note 4, at 40524, 5.

¹¹ Approval Order, supra note 3, at n. 98.

¹² See No-Action Letter re: DB Commodity Index Tracking Fund and DB Commodity Services LLC (Jan. 19, 2006); No-Action Letter re: Rydex Specialized Products LLC (Dec. 5, 2005); No-Action Letter re: streetTRACKS Gold Trust (Dec. 12, 2005); and No-Action Letter re: iShares COMEX Gold Trust (Dec. 12, 2005) (collectively, the "CBETT No-Action Relief"). While the CBETT No-Action Relief does not explicitly use the terms "AP Broker-Dealer" and "Non-AP Broker-Dealer" as found in the SIA Exemption, the Exchange believes that their usage herein is consistent with the substance of the relief granted in the CBETT No-Action Relief.

II. Rationale for Relief for Broker-Dealers Involved in the Incentive Program

The Exchange believes that it is necessary and appropriate in the public interest and is consistent with the protection of investors to provide exemptive and no-action relief from Section 11(d)(1) and Rule 11d1-2 thereunder to LMMs, including both Broker-Dealer APs and Non-AP Broker-Dealers, receiving an LMM Payment under the Incentive Program for the following reasons, which are set forth in more detail below. First, the Incentive Program is designed to enhance market quality, not push shares. Second, absent exemptive and no-action relief, the Exchange may not attract a sufficient number of LMMs to participate in the Incentive Program to make it successful. Third, the Incentive Program is limited in time and scope so that the effect of the requested exemptive and no-action relief will be very narrow. Finally, investors in ETPs participating in the Incentive Program will be further protected by substantial public disclosures made in connection with the Incentive Program.

A. Incentive Program Is Designed to Enhance Market Quality, Not to Encourage “Share Pushing”

As described at length in the Notice, the purpose of the Incentive Program is to improve market quality in low-volume ETPs by incentivizing Market Makers to serve as LMMs for such products.¹³ The Exchange believes that the presence of an obligated and accountable liquidity provider leads to superior market quality and thus benefits long-term investors, particularly in comparison to similar securities for which there are no LMMs assigned. The Exchange believes that the Incentive Program will help foster enhanced liquidity, robust quoting activity, narrowed spreads, and reduced transaction costs for investors in participating ETPs.

The Exchange does not believe that the structure of the Incentive Program, or the payments thereunder, would lead to “share pushing” because all of the standards that an LMM must meet to receive an LMM Payment under the Incentive Program and maintain such status relate to maintaining rigorous two-sided quoting activity, not to execution activity. First, like all Exchange Market Makers, LMMs participating in the Incentive Program must satisfy the requirements of Rule 7.23 for maintaining continuous, two-sided trading interest where the price of the bid (offer) interest is not more than a designated percentage away from the then current NBBO. Second, LMMs must meet a “Market Wide Requirement,” under which an LMM must maintain quotes or orders at the NBBO or better (the “Inside”) during the month during Core Trading Hours in accordance with certain maximum width and minimum depth thresholds based on daily share volume and share price, as set forth in Commentary .01 to Rule 8.800, unless the thresholds are otherwise met by quotes or orders of all market participants across all markets trading the security. Third, LMMs must meet an “NYSE Arca-Specific Requirement” under which the LMM must maintain quotes or orders on NYSE Arca at the NBBO that meet either a time-at-the-Inside requirement or a size-setting NBBO requirement. Fourth, for at least 90% of the time when quotes may be entered during Core Trading Hours each trading day, as averaged over the course of a month, an LMM must maintain: (A) at least 2,500 shares of attributable, displayed posted buy liquidity on the Exchange that is priced no more than 2% away from the NBB for the particular ETP; and (B) at least 2,500 shares of

¹³ See Notice, supra note 3, at 21682-85.

attributable, displayed posted offer liquidity on the Exchange that is priced no more than 2% away from the NBO for the particular ETP. Finally, an LMM that does not meet these quoting requirements does not receive an LMM Payment, and an LMM that does not meet or exceed these performance standards for any two of the three months of a quarter or for five months during the pilot period is subject to losing its LMM status and having the ETP reallocated to another LMM. These substantial responsibilities for quoting on both sides of the market under both Rules 7.23 and 8.800 would be inconsistent with the actions of a broker-dealer pushing, i.e., just offering, shares.

Furthermore, the Incentive Program will be administered by the staff of the Exchange, which is a self-regulatory organization, and which will be interposed between LMMs and issuers. The Exchange will collect the Optional Incentive Fees from issuers and credit them to the Exchange's general revenues. The Exchange will administer all aspects of the LMM Payments, and an LMM will be eligible to receive an LMM Payment, again from the Exchange's general revenues, only after it meets the LMM Performance Standards set and monitored by the Exchange. Application to, continuation in, and withdrawal from the Incentive Program will be governed by published Exchange rules.

B. Incentive Program Pilot Is Unlikely to Attract Sufficient LMMs Without Relief

The Incentive Program's goal of enhancing the market quality for ETPs is most likely to be accomplished by incentivizing as many Market Makers as possible to take LMM assignments in the Incentive Program. Based on discussions with potential LMMs, the Exchange believes that many otherwise eligible Market Makers will not apply to be an LMM in the Incentive Program if exemptive and no-action relief from Section 11(d)(1) and Rule 11d1-2 is unavailable because such Market Makers already offer credit to their customers. The Exchange believes that if these firms are forced to choose between an LMM assignment in the Incentive Program or continuing to offer credit under available exemptive and no-action relief, they will choose the latter because the LMM Payment would not be significant enough to outweigh the value of offering credit services to customers. Without the requested relief, the pool of eligible LMMs would be limited to broker-dealers that do not extend credit to customers. The Exchange believes that this pool may be so small that the Incentive Program may be unable to operate as intended without the requested relief from Section 11(d)(1) and Rule 11d1-2.¹⁴ The Exchange believes that the requested relief will encourage a larger number of Market Makers to participate in the Incentive Program as LMMs and thereby increase the potential for achieving the market quality improvement goals of the Incentive Program. Thus, the requested relief would permit all LMMs to have the opportunity to participate in the Incentive Program rather than excluding certain LMMs because they extend credit to customers.

¹⁴ The Exchange notes that the Commission similarly granted exemptive relief from Regulation M and FINRA Rule 5250 in order to permit the Incentive Program to operate effectively. See Approval Order, supra note 3, at nn. 7 and 85. See also Securities Exchange Act Release Nos. 69707 (June 6, 2013), 78 FR 35330 (June 12, 2013) (Order Granting a Limited Exemption from Rule 102 of Regulation M Concerning the NYSE Arca, Inc.'s Exchange-Traded Product Incentive Program Pilot Pursuant to Regulation M Rule 102(e)) (the "Regulation M Exemption Order") and 69398 (Apr. 18, 2013), 78 FR 24261 (Apr. 24, 2013) (SR-FINRA-2013-020).

C. Incentive Program Is a Pilot That Is Limited in Time and Scope

The Exchange also believes that the requested exemptive and no-action relief is appropriate because the Incentive Program is a pilot program that is limited in both time and scope. The Incentive Program is limited to a one-year pilot period, which will allow for assessment of whether the Incentive Program is achieving its market quality improvement goals, and, prior to any proposal or determination to make the program permanent, whether the Incentive Program has any unintended impact on ETPs, other securities or market participants, generally. In connection with such evaluation, the Exchange will provide the Commission with periodic reports about market quality.¹⁵ In light of the pilot status of the Incentive Program, it will only be necessary for the requested relief to run concurrently with the pilot period during which the Incentive Program operates, which would include any extensions of the pilot period, if approved by the Commission.

Moreover, the subset of ETPs that are eligible to participate in the Incentive Program is limited to those with a CADV of fewer than one million shares. The Incentive Program will terminate with respect to a participating ETP if the ETP sustains a CADV of one million shares or more for three consecutive months.

D. Investors Will Be Protected by Significant Public Disclosure

The Incentive Program also includes significant public disclosure provisions that will help to alert and educate potential and existing investors in the ETPs about the Incentive Program and the payments thereunder.¹⁶ Specifically, the Exchange will disclose on its website the following information with respect to the operation of the Incentive Program: (i) the ETPs participating in the Incentive Program and the LMM assigned to each participating ETP; (ii) the date a particular ETP begins participating or ceases participating in the Incentive Program; (iii) the date the Exchange receives written notice of an issuer's intent to withdraw its ETP from the Incentive Program, or an LMM's intent to withdraw from its ETP assignment(s) in the Incentive Program, and, in each case, the intended withdrawal date, if provided; and (iv) the amount of the Optional Incentive Fee for each ETP. The Exchange also will include on its website a fair and balanced description of the Incentive Program, including a description of the potential benefits and risks that may be attendant with an ETP's participation in the program. An issuer of an ETP that is approved to participate in the Incentive Program will also be required to (i) issue a press release to the public when an ETP commences or ceases participation in the Incentive Program, (ii) post such press release on its website, and (iii) provide on its website a hyperlink to the Exchange's webpage describing the Incentive Program. The Exchange believes that these disclosures about the LMM Payments should allay concerns that a broker-dealer could push shares on uninformed investors.

¹⁵ See Approval Order, *supra* note 3, at 35346.

¹⁶ See Rule 8.800(b)(6) and (7).

III. Specific Request for Relief

For the reasons stated above, the Exchange respectfully requests that the Commission grant an exemption under Section 36(a) of the Act¹⁷ such that Broker-Dealer APs and Non-AP Broker-Dealers that participate in the Incentive Program may rely on the SIA Exemption pertaining to Section 11(d)(1) and Rule 11d1-2 thereunder, subject to the conditions provided in that exemption, notwithstanding that Broker-Dealer APs and Non-AP Broker-Dealers may receive LMM Payments as described in this request. Further, the Exchange requests that the Staff grant no-action relief from Section 11(d)(1) and Rule 11d1-2 thereunder such that Broker-Dealer APs and Non-AP Broker-Dealers that participate in the Incentive Program may rely on the CBETT No-Action Relief pertaining to Section 11(d)(1) and Rule 11d1-2 thereunder, subject to the conditions provided in that exemption, notwithstanding that Broker-Dealer APs and Non-AP Broker-Dealers may receive LMM Payments as described in this request. The exemptive and no-action relief would expire when the Incentive Program terminates, and would be subject to modification or revocation at any time the Commission determines that such action is necessary or appropriate in furtherance of the purposes of the Act.

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If you have any questions concerning this request, please contact Sudhir Bhattacharyya at 212.656.2920.

Very truly yours,



Executive Vice President and Secretary
NYSE Euronext

¹⁷ 15 U.S.C. 78mm(a).