SECURITIES AND EXCHANGE COMMISSION

Self-Regulatory Organizations; NYSE Arca, Inc.: Order Disapproving Proposed Rule Change To Remove the Exchange’s Quote Mitigation Plan as Provided in Commentary .03 to Exchange Rule 6.86

I. Introduction

On October 2, 2014, NYSE Arca, Inc. (“NYSE Arca” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), and Rule 19b-4 thereunder, a proposed rule change to remove the Exchange’s quote mitigation plan as provided in Commentary .03 to NYSE Arca Rule 6.86. The proposed rule change was published for comment in the Federal Register on October 21, 2014. On December 2, 2014, pursuant to Section 19(b)(2) of the Act, the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change. On January 8, 2015, the Exchange submitted a comment letter in further support of its proposal. On January 16, 2015, the Commission issued an Order Instituting Proceedings to Determine Whether to Approve or Disapprove the proposed rule change. On February 27, 2015 and June 4, 2015, the Exchange submitted comment letters in further support of its proposal. No additional comment letters were submitted. This order disapproves the proposed rule change.

II. Description of the Proposal

In 2007, the Exchange adopted a quote mitigation plan in connection with the Options Penny Pilot Program (“Penny Pilot”). According to the exchange, the quote mitigation plan was designed to reduce the number of quotation messages sent by the Exchange to the Options Price Reporting Authority (“OPRA”) by only submitting quote messages for “active” series. The Exchange defines active series under the quote mitigation plan in Commentary .03 to Exchange Rule 6.86 as: (i) Series that have traded on any options exchange in the previous 14 calendar days; or (ii) series that are solely listed on the Exchange; or (iii) series that have been trading ten days or less; or (iv) series for which the Exchange has received an order. In addition, under the Exchange’s quote mitigation plan, the Exchange may define a series as active on an intraday basis if: (i) The series trades at any options exchange; (ii) the Exchange receives an order in the series; or (iii) the Exchange receives a request for quote from a customer in that series.

The Exchange proposes to remove its quote mitigation plan from its rules by deleting Commentary .03 to Exchange Rule 6.86. The Exchange states that its quote mitigation plan is no longer necessary primarily for three reasons. First, the Exchange states that its incorporation of select provisions of the Options Listing Procedures Plan (“OLPP”) serves to reduce the potential for excess quoting because the OLPP limits the number of options series eligible to be listed, which, according to the Exchange, reduces the number of options series a market maker would be obligated to quote. Second, the quote mitigation plan the Commission stated that “because the Commission expects that the Penny Pilot Program will increase quote message traffic, the Commission is also approving the Exchange’s proposal to reduce the number of quotations it disseminates.” See Quote Mitigation Approval Order at 4760. See also Notice, supra note 3, at 62983. See Notice, supra note 3, at 62983.

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Exchange states its view that Exchange Rule 6.37B Commentary .01, which removes certain options series from market makers’ continuous quoting obligations, reduces the number of quote messages that the Exchange sends to OPRA.16 The Exchange states that reliance on the OLPP, via Exchange Rule 6.4A, and the refined market maker quoting obligations, pursuant to Commentary .01 to Exchange Rule 6.37B, is sufficient as a quote mitigation plan.17 Third, the Exchange states that both the Exchange’s systems capacity and OPRA’s systems capacity are more than sufficient to accommodate any additional increase in quote message traffic that might be sent to OPRA as a result of the deletion of the quote mitigation plan.18 The Exchange represents that it continually assesses its capacity needs and ensures that the capacity that it requests from OPRA is sufficient and compliant with the requirements established in the OPRA Capacity Guidelines.19

The Exchange further represents that it has in place certain measures that act as additional safeguards against excessive quoting.20 According to the Exchange, these safeguards include monitoring and alerting market makers disseminating an unusual number of quotes, a business plan designed to ensure that new listings are actively traded,21 and a ratio threshold fee designed to encourage the efficient use of orders.22

III. Summary of Comment Letters

NYSE Arca submitted three comment letters in which it: (1) Supports its position that Rule 6.4A of the OLPP adopted select provisions of the OLPP into Exchange Rule 6.4A).23

Commentary .01 to Exchange Rule 6.37B states that Exchange market makers continuous quoting obligations do not apply “to adjusted option series, and series with a time to expiration of nine months or greater, for options on equities and Exchange Traded Fund Shares, and series with a time to expiration of twelve months or greater for Index options.” See also Notice, supra note 3, at 62984.

The Exchange states its view that limiting the number of options series listed on the Exchange is preferable to suppressing the quotes of inactive options series, as required under current Exchange Rule 6.86, because all quotes sent by Exchange market makers are actionable even if not displayed. See id.

The Exchange further argues that it has in place certain measures that act as additional safeguards against excessive quoting. According to the Exchange, these safeguards include monitoring and alerting market makers disseminating an unusual number of quotes, a business plan designed to ensure that new listings are actively traded, and a ratio threshold fee designed to encourage the efficient use of orders.22

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The Exchange also supplies an actual illustration of how it has in place certain measures that act as additional safeguards against excessive quoting.20 According to the Exchange, these safeguards include monitoring and alerting market makers disseminating an unusual number of quotes, a business plan designed to ensure that new listings are actively traded,21 and a ratio threshold fee designed to encourage the efficient use of orders.22

The Exchange further states its belief that ORPA also would be able to accommodate any increase in quote message traffic resulting from NYSE Arca’s rules that it lists, including those without continuous quoting obligations for market makers, will generate message traffic to OPRA.34 The Exchange further states its belief that ORPA also would be able to accommodate any increase in quote message traffic resulting from NYSE Arca no longer suppressing quotes in inactive series.35

The Exchange further argues that eliminating its quote mitigation plan is consistent with the Act because the Exchange actively monitors market maker quoting activity and alerts market makers to heightened levels of quoting activity, which could result from systems issues or an incorrectly set parameter that generates erroneous quotes.36 The Exchange notes that NYSE Arca’s requests for capacity to the ISCA are adjusted to account for “some level” of erroneous quotes.37

The Exchange also states that the landscape regarding quote message traffic and capacity has changed since the adoption of the Penny Pilot.38 NYSE
Arca represents that in January 2007, 15% of quotes received by the Exchange were not sent to OPRA, compared to 5.8% as of April 2015. The Exchange also states that at the time the Penny Pilot was adopted, OPRA’s total capacity was set to 359,000 messages per seconds (“mps”), and that by July 2015, OPRA’s peak capacity is anticipated to be 42,100,000 mps. In addition, the Exchange states, based on peak message traffic figures on the Exchange for one day in May 2015, if the quotes the Exchange supported in the proposed rule change had been sent to OPRA, industry quotes published by OPRA would have increased by no more than 1%, and that this would use less than .05% of total OPRA capacity.

IV. Discussion

Under Section 19(b)(2)(C) of the Act, the Commission shall approve a proposed rule change of a self-regulatory organization if the Commission finds that such proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to such organization. The Commission shall disapprove a proposed rule change if it does not make such a finding. Rule 700(b)(3) of the Commission’s Rules of Practice states that the “burden to demonstrate that a proposed rule change is consistent with the [Act] . . . is on the self-regulatory organization that proposed the rule change” and that a “mere assertion that the proposed rule change is consistent with the [Act] . . . is on the self-regulatory organization that proposed the rule change” and that a “mere assertion that the proposed rule change is consistent with those requirements . . . is not sufficient.”

After careful consideration, the Commission cannot find that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. In particular, the Commission cannot find that the proposed rule change is consistent with Section 6(b)(5) of the Act, which requires that the rules of a national securities exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and to protect investors and the public interest.

In conjunction with the adoption of the Penny Pilot in 2007 that permitted the options exchanges to quote certain options series in one and five cent increments, and in response to a letter sent by the then Chairman of the Commission, including NYSE Arca, adopted quote mitigation plans. The Commission emphasized the importance of options exchanges’ quote mitigation strategies in connection with the Penny Pilot in its orders approving an expansion of the Penny Pilot in 2007. In those orders, the Commission noted that options exchanges participating in the Penny Pilot would continue to use quote mitigation strategies. Likewise, when the Commission approved NYSE Arca’s proposal to again expand the Penny Pilot in 2009, the Commission reiterated that the Exchange would retain and continue to employ its quote mitigation strategy.

When considering whether the Exchange’s quote mitigation plan was consistent with the Act, the Commission relied upon supporting data and analysis provided by the Exchange. In its proposal to provide for a quote mitigation plan, NYSE Arca represented that the quote mitigation plan was intended to reduce the number of quotations generated by the Exchange for all option issues traded at NYSE Arca, not just options on issues included in the Penny Pilot, and that the Exchange anticipated the quote mitigation plan would reduce quote message traffic by 20–30%. In approving NYSE Arca’s proposal in February 2007, the Commission stated that because it expected that the Penny Pilot would increase quote message traffic, the Commission also approved the Exchange’s proposal to reduce the number of quotations it disseminates.

In 2007 and 2009, the Commission approved rule changes submitted by NYSE Arca expanding the number of classes eligible to participate in the Penny Pilot. In so approving, the Commission reviewed data provided by the options exchanges, including data relating to OPRA’s capacity to process the increase in quotes resulting from the expansion of the Penny Pilot and the effectiveness of its quote mitigation plan. In approving each of these expansions, the Commission noted that...
it relied, in part, on the Exchange’s representation that it would continue to use its quote mitigation plan to suppress certain quotation traffic that would otherwise be sent to OPRA. The Commission also relied on data provided by the options exchanges to support representations that capacity was not a concern, and that the quote mitigation plans in place were successful.

For example, NYSE Arca provided the Commission with data supporting its claim that the Exchange’s quote mitigation plan mitigated 12.1 million quote messages, a drop of 13 percent of NYSE Arca’s daily quote message traffic sent to OPRA. In another report, NYSE Arca provided data on OPRA’s then-current capacity, future capacity, and peaks in message traffic sent to OPRA to support its argument that quote traffic increases were manageable.

As noted above, the Exchange believes that its quote mitigation plan is no longer necessary because: (1) the Exchange has incorporated select provisions of the OLPP in Exchange Rule 6.37B, which the Exchange believes limits the number of series eligible to be traded; (2) current Exchange Rule 6.37B Commentary .01 removes certain options series from market makers’ continuous quoting obligations, which the Exchange believes reduces the number of quote messages that the Exchange sends to OPRA; and (3) both the system capacity at the Exchange and at OPRA are more than sufficient to accommodate any additional increase in quote message traffic that might be disseminated if NYSE Arca’s quote mitigation plan is eliminated. However, the Exchange has not provided the Commission with sufficient data regarding potential changes in quote message traffic if the Commission approves its proposal.

For example, the Exchange does not provide sufficient data about the number of quote messages that its quote mitigation plan currently suppresses relative to capacity at OPRA. Specifically, the Exchange provided data from May 29, 2015 that purports to show that if all quote messages suppressed by the Exchange were instead sent to OPRA, industry quotes published by OPRA would increase by no more than 1%. The Exchange asserts that this increase would use less than .05% of total OPRA capacity across all option exchanges. Importantly, however, the Exchange does not provide data that shows the excess capacity between peak quote message traffic sent from all options exchanges and OPRA’s Peak Capacity for the May 29, 2015 sample. If peak quote message traffic sent to OPRA by all the options exchanges was at or approached OPRA’s Peak Capacity, then potentially even a small increase in message traffic from one exchange could result in OPRA’s capacity being exceeded.

In addition, the Exchange does not provide data or analysis demonstrating the potential impact the Exchange’s proposal would have on market participants who consume the OPRA and/or the Exchange’s quotation message feeds. Nor does the Exchange quantify the number or percentage of quote messages that have been and would continue to be suppressed as a result of the Exchange’s current Exchange Rule 6.4A or current Exchange Rule 6.37B Commentary .01.

The Commission notes that the Exchange’s comment letter stated its belief that as a result of refined quoting obligations, market makers do not need to quote in approximately 5,000 options series, and that this has resulted in a decrease in message traffic, however, the Exchange did not provide data to quantify the decrease in message traffic for the Commission to consider. Absent sufficient information and data of this type, the Commission is not able to adequately evaluate the Exchange’s assertion that “reliance on the OLPP, via Rule 6.4A, together with the refined market maker obligation, pursuant to Commentary .01 to Rule 6.37B, is sufficient as a quote mitigation strategy and obviates the need for Rule 6.86.”

Other information or data may also be helpful for the Commission’s consideration of the proposed rule change. Without sufficient supporting data and analysis, the Commission is not able to adequately assess the impact of NYSE Arca’s proposed rule change to eliminate its quote mitigation plan and make a determination that the proposed rule change is consistent with the Act.

Given the limitations in the data provided by NYSE Arca, as described above, the Commission cannot find a sufficient basis to conclude that the proposal is consistent with the Act. The Commission notes, however, that the Penny Pilots for each of the options exchanges are anticipated to be extended for an additional year, until June 30, 2016. In connection with any future requests to extend the Penny Pilots after that date, the Commission intends to require each exchange to submit detailed information to allow for permanent approval or disapproval by the Commission. Such proposals should, among other things, provide detailed data and analysis to support the efficacy, or any proposed modification or elimination, of any exchanges’ quote mitigation plan.


64 See NYSE Arca Letter 1, supra note 6, at 3.
65 See Notice, supra note 3, at 62964.
66 See footnote 65.

61 See Order Approving Expansion 2, supra note 55 at 49421 (The Commission noted that several commenters expressed concerns that increased quotation message traffic imposes costs on exchanges and other market participants to process and store the additional quotations and they questioned the ability of market systems to effectively handle the increased quote message traffic that would likely result from the expansion of the Penny Pilot to 363 classes. In approving the expansion, the Commission noted that NYSE Arca “had adopted an option to utilize quote mitigate strategies that should continue to mitigate the expected increase in quotation traffic.” Id. at 49422–23.
62 In 2009, the OLPP Participants, including NYSE Arca, represented that the new strategy they were proposing as Amendment No. 3 to the OLPP (which was subsequently codified as Rule 6.4A on the Exchange’s rulebook) would be “an add-on strategy” to be used to address overall capacity concerns in the industry. See Securities Exchange Act Release No. 60365 (July 22, 2009), 74 FR 37266 (July 28, 2009) (Notice of Filing of Amendment No. 3 to the OLPP proposing uniform standards to the range of options series exercise prices available for trading). Although it was anticipated that the exercise price limitation bands set forth in Amendment No. 3 would also have the attendant benefit of further reducing increases in quote message traffic, the language in the exchanges’ OLPP filings suggest that the methodology set forth in Amendment No. 3 (to limit the number of options series available for trading) was intended to replace the options exchanges’ quote mitigation strategies, nor does the language in those filings suggest that it was contemplated at the time that the options exchanges would eliminate their existing exchange-specific quote mitigation strategies.
63 While NYSE Arca stated in its proposed rule change to adopt Exchange Rule 6.37B Commentary .01 that the burden of increased quote volume, if a new option series is added, is counter to efforts to mitigate the number of quotes collected and disseminated, and that the proposal would further the goal of quote mitigation, this was not a basis given for the
SECURITIES AND EXCHANGE COMMISSION
[Investment Company Act Release No. 31679; 812–14358]

Academy Funds Trust and Innovator Management LLC; Notice of Application

June 17, 2015.

ACTION: Notice of an application under section 6(e)(c) of the Investment Company Act of 1940 (the “Act”) for an exemption from section 15(a) of the Act and rule 18f–2 under the Act.

SUMMARY OF APPLICATION: Applicants request an order that would permit them to enter into and materially amend subadvisory agreements without shareholder approval.

APPLICANTS: Academy Funds Trust (the “Trust”) and Innovator Management LLC (“Innovator” or the “Adviser”).

FILING DATES: The application was filed on September 12, 2014 and amended on January 28, 2015, May 12, 2015 and June 3, 2015.

1 Applicants also request relief with respect to any existing or future series of the Trust and any other existing or future registered open-end management investment company or series thereof that: (a) is advised by Innovator or its successors, including any entity controlling, controlled by or under common control with Innovator or its successors (included in the term “Adviser”); (b) uses the manager-of-managers structure (“Manager of Managers Structure”) described in the application; and (c) complies with the terms and conditions of the application (each a “Fund” and together, the “Funds”). The only existing investment company that currently intends to rely on the requested order, the Trust, is named as an applicant. For purposes of the requested order, “successor” is limited to an entity that results from a reorganization into another jurisdiction or a change in the type of organization.

2 Innovator or another Adviser will enter into substantially similar investment advisory agreements to provide investment management services to each future Fund (each included in the term “Advisory Agreement”). Each other Adviser will also be registered as an investment adviser under the Advisers Act.

3 Applicants are not seeking any exemptions with respect to the Advisory Agreements.