

# Information Memo



Number 12-19  
July 31, 2012

**TO: ALL MEMBERS AND MEMBER ORGANIZATIONS**

**SUBJECT: NEW RULE 107C: RETAIL LIQUIDITY PROGRAM**

## **I. Purpose**

The purpose of this Information Memo is to inform New York Stock Exchange LLC ("NYSE") and NYSE MKT LLC ("NYSE MKT") (collectively, the "Exchange") member organizations that the Exchange's recently approved Retail Liquidity Program (the "Program"), as described in new Exchange Rule 107C, will begin on **August 1, 2012** as a one-year pilot.

## **II. New Rule 107C – Overview**

The Exchange adopted the Program to attract additional retail order flow to the Exchange in NYSE-listed and NYSE MKT-traded securities, while also providing price improvement to such order flow. As approved by the Securities and Exchange Commission, the Exchange has created two new classes of market participants: (1) Retail Member Organizations ("RMOs"), which would be eligible to submit certain retail order flow ("Retail Orders") to the Exchange, and (2) Retail Liquidity Providers ("RLPs"), which would be required to provide potential price improvement for Retail Orders in the form of non-displayed interest that is better than the best protected bid or the best protected offer ("PBBO") ("Retail Price Improvement Order" or "RPI"). Member organizations other than RLPs would also be permitted, but not required, to submit Retail Price Improvement Orders.

Rule 107C sets forth the definitions for the Program, as follows:

- An "RMO" is a member organization (or division thereof) that has been approved by the Exchange under Rule 107C to submit Retail Orders. (*Rule 107C(a)(2)*)
- An "RLP" is a member organization that has been approved by the Exchange to act as such and is required to submit Retail Price Improvement Orders in accordance with the Rule. (*Rule 107C(a)(1)*)
- A "Retail Order" is an agency order that originates from a natural person and is submitted to the Exchange by an RMO, provided that no change is made to the terms of the order with respect to price or side of market and the order does not originate from a trading algorithm or any other computerized methodology. A Retail Order is an Immediate or Cancel Order and may be an odd lot, round lot, or PRL. (*Rule 107C(a)(3)*)

- Note that an RMO may use a routing algorithm to determine to send an existing Retail Order to the Exchange, provided that the RMO assures that the Retail Order meets the underlying rule requirements, including that the routing algorithm does not change the terms of the order with respect to price or side of the market. Additionally, the Retail Order provision preventing changes to the terms of the order (e.g., price or side) is not meant to prevent an RMO from ensuring a better execution experience for the retail customer, such as by adding a limit to a Retail Order.
- A “Retail Price Improvement Order” or “RPI” consists of non-displayed interest in Exchange-traded securities that is priced better than the best protected bid (“PBB”) or best protected offer (“PBO”), by at least \$0.001 and that is identified as such. Exchange systems will monitor whether RPI buy or sell interest, adjusted by any offset and subject to the ceiling or floor price, is eligible to interact with incoming Retail Orders. An RPI remains non-displayed in its entirety. An RLP shall only enter and RPI for securities to which it is assigned as RLP. Member organizations other than RLPs are permitted, but not required, to submit RPIs. An RPI may be an odd lot, round lot, or PRL. *(Rule 107C(a)(4))*

The price of an RPI would be determined by the entry of the following into Exchange systems: (1) RPI buy or sell interest; (2) an offset, if any; and (3) a ceiling or floor price. The Exchange expects that RPI sell or buy interest typically would be entered to track the PBBO. The offset would be a predetermined amount by which the RLP is willing to improve the PBBO, subject to a ceiling or floor price. The ceiling or floor price would be the amount above or below which the RLP does not wish to trade.

- A “Retail Liquidity Identifier” shall be disseminated through proprietary data feeds, or as appropriate, through the Consolidated Quotation System, when RPI interest priced at least \$0.001 better than the PBB or PBO for a particular security is available in Exchange systems. The Retail Liquidity Identifier shall reflect the symbol for the particular security and the side (buy or sell) of the RPI interest, but shall not include the price or size of the RPI interest. *(Rule 107C(j))*

Exchange systems would prevent Retail Orders from interacting with Retail Price Improvement Orders if the RPI is not priced at least \$0.001 better than the PBBO. The price improvement of \$0.001 would be a minimum requirement and RLPs and other member organizations could enter Retail Price Improvement Orders that better the PBBO by more than \$0.001. Exchange systems will accept Retail Price Improvement Orders without a minimum price improvement value; however, such interest will execute at its floor or ceiling price only if such floor or ceiling price is better than the PBBO by \$0.001 or more.

RPIs would interact with Retail Orders as follows. Assume an RLP enters RPI sell interest with an offset of \$0.001 and a floor of \$10.10 while the PBO is \$10.11. The RPI could interact with an incoming buy Retail Order at \$10.109. If, however, the PBO was \$10.10, the RPI could not interact with the Retail Order because the price required to deliver the minimum \$0.001 price improvement (\$10.099) would violate the RLP’s floor of \$10.10.

If an RLP otherwise enters an offset greater than the minimum required price improvement and the offset would produce a price that would violate the RLP's floor, the offset would be applied only to the extent that it respects the RLP's floor. By way of illustration, assume RPI buy interest is entered with an offset of \$0.005 and a ceiling of \$10.112 while the PBB is at \$10.11. The RPI could interact with an incoming sell Retail Order at \$10.112, because it would produce the required price improvement without violating the RLP's ceiling, but it could not interact above the \$10.112 ceiling. Finally, if an RLP enters an RPI without an offset, the RPI will interact with Retail Orders at the level of the RLP's floor or ceiling as long as the minimum required price improvement is produced. Accordingly, if RPI sell interest is entered with no offset and a \$10.098 floor while the PBO is \$10.11, the RPI could interact with the Retail Order at \$10.098, producing \$0.012 of price improvement.

Exchange systems will not cancel RPI interest when it is not eligible to interact with incoming Retail Orders; such RPI interest will remain in Exchange systems and may become eligible again to interact with Retail Orders depending on the PBB or PBO.

Additional details regarding the Program, including technical specifications, RMO applications, and RLP applications, are available at [www.nyx.com](http://www.nyx.com).<sup>1</sup>

### III. **New Rule 107C – RMO**

Member organizations that conduct a retail business or that handle retail orders on behalf of another broker-dealer are eligible to apply to become an RMO. Any member organization that wishes to obtain RMO status would be required to submit: (1) an application form; (2) an attestation, in a form prescribed by the Exchange, that any order submitted by the member organization as a Retail Order would meet the qualifications for such order under Rule 107C(a)(3); and (3) supporting documentation sufficient to demonstrate the retail nature and characteristics of the applicant's order flow.

For example, a prospective RMO could be required to provide sample marketing literature, website screenshots, other publicly disclosed materials describing the retail nature of their order flow, and such other documentation and information as the Exchange may require to obtain reasonable assurance that the applicant's order flow would meet the requirements of the Retail Order definition.

An RMO must have written policies and procedures reasonably designed to assure that it will only designate orders as Retail Orders if all requirements of a Retail Order are met. Such written policies and procedures must require the RMO to:

- exercise due diligence before entering a Retail Order to assure that entry as a Retail Order is in compliance with the requirements of Rule 107C; and
- monitor whether orders entered as Retail Orders meet the applicable requirements.

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<sup>1</sup> The Exchange has published Trader Updates that include links to the technical specifications applicable to the Program, the RMO Application, the RLP Application, and the RMO – Broker-dealer Agreement, among other things. See <http://usequities.nyx.com/nyse/trader-updates/view/11177>.

If an RMO represents Retail Orders from another broker-dealer customer, the RMO's supervisory procedures must be reasonably designed to assure that the orders it receives from such broker-dealer customer that it designates as Retail Orders meet the definition of Retail Order. The RMO must:

- obtain an annual written representation, in a form acceptable to the Exchange, from each broker-dealer customer that sends it orders to be designated as Retail Orders that entry of such orders as Retail Orders will be in compliance with the requirements of Rule 107C; and
- monitor whether its broker-dealer customer's Retail Order flow continues to meet the applicable requirements.

On behalf of the Exchange, FINRA will review an RMO's compliance with these requirements.

There are three types of Retail Orders that an RMO may submit:

- Type-1 designated Retail Orders would interact only with available contra-side Retail Price Improvement Orders and would not interact with other available contra-side interest in Exchange systems or route to other markets. The portion of a Type-1 Retail Order that does not interact with available contra-side Retail Price Improvement Orders would be immediately and automatically cancelled.
- Type-2 designated Retail Orders would interact first with available contra-side Retail Price Improvement Orders and any remaining portion of the Retail Order would be executed as a Regulation NMS-compliant Immediate or Cancel Order pursuant to Rule 13. Accordingly, a Type 2-designated Retail Order could interact with other interest in Exchange systems, but would not route to other markets.
- Type-3 designated Retail Orders would interact first with available contra-side Retail Price Improvement Orders and any remaining portion of the Retail Order would be executed as an NYSE Immediate or Cancel Order pursuant to Rule 13. Accordingly, a Type 3-designated Retail Order could interact with other interest in Exchange systems and, if necessary, would route to other markets in compliance with Regulation NMS.

The Exchange notes that an RMO may enter Retail Orders on a riskless principal basis, provided that (i) the entry of such riskless principal orders meet the requirements of Rule 5320.03, including that the RMO maintains supervisory systems to reconstruct, in a time-sequenced manner, all Retail Orders that are entered on a riskless principal basis; and (ii) the RMO does not include non-Retail Orders together with the Retail Orders as part of a riskless principal transaction.

If the Exchange disapproves an application for RMO status, it will provide written notice to the member organization. As set forth in Rule 107C(i), the disapproved applicant could appeal the disapproval by the Exchange and/or reapply for RMO status 90 days after the disapproval notice is issued by the Exchange. An RMO also could voluntarily withdraw from such status at any time by giving written notice to the Exchange.

If an RMO fails to abide by the Retail Order requirements, for example, if the Exchange determines, in its sole discretion that orders entered by the RMO fail to meet any of the requirements of Retail Orders, the Exchange may disqualify a member organization from its status as a member organization. A disqualified RMO could appeal the disqualification pursuant to Rule 107C(i) and/or reapply for RMO status 90 days after the disqualification notice is issued by the Exchange.

#### **IV. New Rule 107C – RLPs**

To qualify as an RLP under Rule 107C(c), a member organization must: (1) already be approved as a Designated Market Maker (“DMM”) or Supplemental Liquidity Provider (“SLP”); (2) demonstrate an ability to meet the requirements of an RLP; (3) have mnemonics or the ability to accommodate other Exchange-supplied designations that identify to the Exchange RLP trading activity in assigned RLP securities; and (4) have adequate trading infrastructure and technology to support electronic trading.

Because an RLP would only be permitted to trade electronically, a member organization’s technology must be fully automated to accommodate the Exchange’s trading and reporting systems that are relevant to operating as an RLP. If a member organization were unable to support the relevant electronic trading and reporting systems of the Exchange for RLP trading activity, it would not qualify as an RLP.

The approval process for an RLP is set forth in Rule 107C(d). In order to be eligible for execution fees that are lower than non-RLP rates, an RLP must maintain (1) a Retail Price Improvement Order that is better than the PBB at least five percent of the trading day for each assigned security; and (2) a Retail Price Improvement Order that is better than the PBO at least five percent of the trading day for each assigned security.<sup>2</sup>

An RLP’s five-percent requirements would be calculated by determining the average percentage of time the RLP maintains a Retail Price Improvement Order in each of its RLP securities during the regular trading day, on a daily and monthly basis. The Exchange would determine whether an RLP has met this requirement by calculating the following:

- (1) The “Daily Bid Percentage” would be calculated by determining the percentage of time an RLP maintains a Retail Price Improvement Order with respect to the PBB during each trading day for a calendar month;
- (2) The “Daily Offer Percentage” would be calculated by determining the percentage of time an RLP maintains a Retail Price Improvement Order with respect to the PBO during each trading day for a calendar month;
- (3) The “Monthly Average Bid Percentage” would be calculated for each RLP security by summing the security’s “Daily Bid Percentages” for each trading day in a calendar month then dividing the resulting sum by the total number of trading days in such calendar month; and

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<sup>2</sup> The fees associated with the Program are set forth on the NYSE and NYSE MKT price lists.

- (4) The “Monthly Average Offer Percentage” would be calculated for each RLP security by summing the security’s “Daily Offer Percentage” for each trading day in a calendar month and then dividing the resulting sum by the total number of trading days in such calendar month.

Only Retail Price Improvement Orders will be used when calculating whether an RLP is in compliance with its five-percent requirements.

The Exchange will determine whether an RLP met its five-percent requirement by determining the average percentage of time an RLP maintains a Retail Price Improvement Order in each of its RLP securities during the regular trading day on a daily and monthly basis. The lower fees would not apply during a month in which the RLP did not satisfy the five-percent requirements.

If, after the first two months an RLP acted as an RLP, an RLP fails to meet the requirements of Rule 107C(f) for any assigned RLP security for three consecutive months, the Exchange could, in its discretion, take one or more following actions: (1) revoke the assignment of any or all of the affected securities from the RLP; (2) revoke the assignment of unaffected securities from the RLP; or (3) disqualify the member organization from its status as an RLP.

A disqualified RLP could appeal the disqualification pursuant to Rule 107C(i) and/or reapply for RLP status 90 days after the disqualification notice is issued by the Exchange.

**V. Staff Contact Information**

Questions regarding the rule requirements applicable to RMOs and RLPs should be directed to:

Clare Saperstein, Vice President, NYSE Regulation, Inc., 212.656.2355, or

David De Gregorio, Chief Counsel, NYSE Regulation, Inc., 212.656.4166,

Questions regarding the RMO and RLP application process and assignment of RLP securities should be directed to:

Robert Airo, Senior Vice President, NYSE Operations, 212.656.5663