

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁵

Robert W. Errett,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-77708; File No. SR-NYSE-2016-16]

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Amend NYSE Rule 98 To Provide That, When Designated Market Makers Enter Interest for the Purpose of Facilitating the Execution of Customer Orders, Those Orders Would Not Be Required To Be Designated as DMM Interest

April 26, 2016.

I. Introduction

On March 4, 2016, New York Stock Exchange LLC (“Exchange” or “NYSE”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) ¹ and Rule 19b-4 thereunder, ² a proposed rule change to amend NYSE Rule 98 governing the operation of a Designated Market Maker (“DMM”) Unit. The proposed rule change was published for comment in the *Federal Register* on March 15, 2016.³ The Commission received no comments on the proposed rule change. On April 15, 2016, the Exchange filed Amendment No. 1 to the proposed rule change.⁴ The Commission

is publishing this notice to solicit comments on Amendment No. 1 from interested persons and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

II. Description of the Proposal, as Modified by Amendment No. 1

The Exchange proposes to amend NYSE Rule 98 to provide that when DMMs ⁵ enter interest on a proprietary basis for the purpose of facilitating the execution of customer orders, that interest would not be required to be designated as DMM interest.

A. Background

The Exchange represents that in 2014 it amended NYSE Rule 98 to adopt a principles-based approach to prohibit the misuse of material nonpublic information by a member organization that operates a DMM unit and to make conforming changes to other Exchange rules.⁶ According to the Exchange, those rule changes provide member organizations operating DMM units with the ability to integrate DMM unit trading with other trading units, while maintaining tailored restrictions to address that DMMs, while on the Trading Floor,⁷ may have access to certain Floor-based non-public information. The Exchange states that, by removing prescriptive restrictions, the 2014 Filing was designed to enable a member organization that engages in market-making operations on multiple exchanges to house its DMM operations together with the other market-making operations, even if those operations are customer-facing, or to enable a member organization to consolidate all of its equity trading, including customer-facing operations and the DMM unit, within a single independent trading unit.

The Exchange states that NYSE Rule 98(c) sets forth specific restrictions on the operation of a DMM unit.⁸ Among

other requirements, NYSE Rule 98(c)(4) provides that any interest entered into Exchange systems by the DMM unit in DMM securities ⁹ must be identifiable as DMM unit interest. NYSE Rule 98(c)(5) provides that a member organization must provide the Exchange, at such times and in the manner prescribed by the Exchange, with real-time net position information for trading in DMM securities by the DMM unit and any independent trading unit of which it is a part. NYSE Rule 98(d) further specifies that the DMM rules ¹⁰ will apply only to a DMM unit’s quoting or trading in its DMM securities for its own accounts at the Exchange. Accordingly, the Exchange states, the DMM rules do not apply to any customer orders that a member organization that operates a DMM unit sends to the Exchange as agent.¹¹

According to the Exchange, because NYSE Rule 98(c)(4) currently requires that any interest entered into Exchange systems by the DMM unit in DMM securities be identifiable as DMM interest, a DMM unit that is integrated with a customer-facing unit and that sends customer orders in DMM securities to the Exchange in a proprietary capacity must identify those customer orders as DMM interest. As a result, although agency orders are not subject to DMM rules, customer-driven interest entered by a DMM unit on a proprietary basis is subject to all DMM rules.

The Exchange states that none of its member organizations operating a DMM have integrated a DMM unit with a customer-facing trading unit. The Exchange believes that the current rule requiring customer-driven orders that are represented on a proprietary basis to be designated as DMM interest has served as a barrier to achieving such integration.¹² Specifically, according to

²⁵ 17 CFR 200.30-3(a)(57).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 77332 (Mar. 9, 2016), 81 FR 13851 (“Notice”).

⁴ Amendment No. 1 is publicly available at <http://www.sec.gov/comments/sr-nyse-2016-16/nyse2016-16.shtml>. Amendment No. 1 replaced the original filing in its entirety. In Amendment No. 1, the Exchange proposes: (1) To clarify that a DMM unit must have received a customer order before it enters a “customer-driven order” in DMM securities at the Exchange; (2) to specify that a DMM unit entering a customer-driven order in DMM securities may do so only if the order is entered on a riskless principal basis or if the order is entered on a principal basis to provide price improvement to the customer; and (3) to provide that a mnemonic used to identify a DMM’s customer-driven orders in DMM securities may not be used for trading activity at the Exchange in DMM securities that are not customer-driven order, but may be used for trading activities in securities not assigned to the DMM. Furthermore, the Exchange has also added additional text to the filing to explain the revisions

contained in Amendment No. 1; to clarify the application of Regulation SHO to DMM orders marked as “customer-driven orders,” see *infra* note 15; and to clarify other aspects of the proposed rule change.

⁵ As defined in NYSE Rule 2(i), the term “DMM” means an individual member, officer, partner, employee or associated person of a Designated Market Maker Unit who is approved by the Exchange to act in the capacity of a DMM.

⁶ See Securities Exchange Act Release Nos. 72534 (July 3, 2014), 79 FR 39019 (July 9, 2014) (Approval Order) and 71837 (Apr. 1, 2014), 79 FR 19146 (Apr. 7, 2014) (SR-NYSE-2014-12) (“2014 Filing”).

⁷ See NYSE Rule 6A for the definition of “Trading Floor.”

⁸ As defined in NYSE Rule 98(b)(1), the term “DMM unit” means a trading unit within a member organization that is approved pursuant to NYSE Rule 103 to act as a DMM unit.

⁹ As defined in NYSE Rule 98(b)(2), the term “DMM securities” means any securities allocated to the DMM unit pursuant to NYSE Rule 103B or other applicable rules.

¹⁰ As defined in NYSE Rule 98(b)(3), the term “DMM rules” means any rules that govern DMM or DMM unit conduct or trading.

¹¹ See 2014 Filing, *supra* note 6 at 19152 (specifying that Rule 98(d) was added because DMM rules are not applicable to any customer orders routed to the Exchange by a member organization as agent).

¹² According to the Exchange, it is a common practice among market makers that operate as wholesalers, and thus have their own customer orders as well as retail order flow from another broker dealer, to facilitate the execution of customer order flow by representing it on a proprietary basis when those orders are routed to an exchange. Once a customer-driven order that has been represented on a proprietary basis on the Exchange has been executed, the market maker uses the position acquired on the Exchange to fill the customer order

the Exchange, there are certain scenarios when the rules governing DMMs may conflict with a member organization's obligations with respect to its customers' orders. For example, DMMs are not permitted to enter Market Orders, MOO Orders, CO Orders, MOC Order, LOC Orders, or orders with Sell "Plus"—Buy "Minus" Instructions.¹³ However, the Exchange represents that, to comply with customer instructions, a customer-driven order entered by a member organization on a proprietary basis may need to use one of these order types. As another example, the Exchange states that DMMs are restricted from engaging in specified trading in the last ten minutes of trading before the close of trading.¹⁴ But, according to the Exchange, a member organization may have a best-execution obligation to route a customer-driven order to the Exchange in the last ten minutes of trading.

B. Proposed Modifications

The Exchange proposes to replace the phrase "any interest" with the phrase "proprietary interest" in NYSE Rule 98(c)(4) to clarify that the existing rule only governs proprietary interest of a DMM unit, *i.e.*, interest for the account of the member organization. As further proposed, the Exchange would amend NYSE Rule 98(c)(4) to provide that proprietary interest entered into Exchange systems by the DMM unit in DMM securities would not be required to be identifiable as DMM unit interest if that interest is (1) represented on a riskless principal basis, or on a principal basis to provide price improvement to the customer; and (2) for the purpose of facilitating the execution of an order received from a customer (whether the DMM unit's own customer or the customer of another broker-dealer). The Exchange proposes to define such interest as a "customer-driven order." A member organization entering a customer-driven order would need to have received a customer order before entering a customer-driven order at the Exchange.

The Exchange also proposes to amend NYSE Rule 98(c)(4) to specify that a DMM unit must use a unique mnemonic that identifies to the Exchange its

customer-driven orders in DMM securities. Such mnemonics may not be used for trading activity at the Exchange in DMM securities that are not customer-driven orders, but may be used for trading activities in securities not assigned to the DMM. The Exchange believes that requiring a separate mnemonic for customer-driven orders would assist the Exchange in monitoring DMM unit compliance with the proposed rule.

The Exchange further proposes to amend NYSE Rule 98(d) to specify that the rules, fees, or credits applicable to DMM quoting or trading activity would apply only to a DMM unit's quoting or trading in its DMM securities that is for its own account at the Exchange and that has been identified as DMM interest. In addition, the Exchange proposes to add text to NYSE Rule 98(d) to state that (1) customer-driven orders for the account of a DMM unit that have not been identified as DMM interest would not be subject to DMM rules or be eligible for any fees or credits applicable to DMM quoting or trading activity; and (2) customer-driven orders not designated as DMM interest would not be subject to DMM rules, which include restrictions on the availability of certain order types and the entry of specified orders during the last ten minutes of trading.

The Exchange represents that the NYSE Rule 98(c)(5) obligation to provide the Exchange with real-time net position information in DMM securities would continue to be applicable to the DMM unit's position in DMM securities together with any position of a Regulation SHO independent trading unit of which the DMM unit may be included, regardless of whether they are positions resulting from trades in away markets, trades as a result of DMM interest entered at the Exchange, or customer-driven orders routed to the Exchange that were not identified as DMM interest.¹⁵ The Exchange also

proposes a non-substantive amendment to NYSE Rule 98(c)(5) to delete the term "for trading," which the Exchange believes is extraneous rule text.

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹⁶ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹⁷ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, 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 Commission believes that the proposed rule change will help 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, because the Exchange has proposed a mechanism that is reasonably designed to distinguish a DMM unit's own proprietary trading on the Exchange in its assigned securities from a DMM unit's activity in representing customer orders as principal. In light of the market-making privileges and obligations of DMMs, the Exchange has

242.203(b)(2)(iii); *see also* Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48015 (Aug. 6, 2004); Securities Exchange Act Release No. 58775 (Oct. 14, 2008), 73 FR 61690, 61698–9 (Oct. 17, 2008). Broker-dealers would not be able to rely on the Exchange's or any self-regulatory organization's designation of market making for eligibility for the bona-fide market making exception to the "locate" requirement, as such designations are distinct and independent from Regulation SHO. Further, the Exchange's designation of proprietary interest or any exclusion from proprietary interest for purposes of NYSE rules is not relevant for purposes of Regulation SHO. Eligibility for the bona-fide market making exception depends on the facts and circumstances and a determination of bona-fide market making is based on the Commission's factors outlined in the aforementioned Regulation SHO releases. It should also be noted that a determination of bona-fide market making is relevant for the purposes of the close-out obligations under Rule 204 of Regulation SHO. *See* 17 CFR 242.204(a)(3).

¹⁶ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

¹⁷ 15 U.S.C. 78f(b)(5).

either on a riskless-principal basis or with price improvement to the customer.

¹³ *See* NYSE Rule 104(b)(vi).

¹⁴ *See* NYSE Rule 104(g)(i)(A)(III) (defining Prohibited Transactions). Specifically, according to the Exchange, a DMM with a long position in a security is prohibited from making a purchase in a security that results in a new high price on the Exchange for the day, and a DMM with a short position in a security is prohibited from making a sale in that security that results in a new low price for the day.

¹⁵ Under Regulation SHO, determination of a seller's net position is based on the seller's position in the security in all of its accounts, absent aggregation unit treatment under Rule 200(f) of Regulation SHO. *See* Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48010, n.22 (Aug. 6, 2004); *see also* Securities Exchange Act Release No. 48709 (Oct. 29, 2003), 68 FR 62972, 62991 and 62994 (Nov. 6, 2003); Letter from Richard R. Lindsey, Director, Division of Market Regulation, to Roger D. Blanc, Wilkie Farr & Gallagher, SEC No-Action Letter, 1998 SEC No-Act. LEXIS 1038, p. 5 (Nov. 23, 1998); Securities Exchange Act Release No. 30772 (June 3, 1992), 57 FR 24415, 24419 n.47 (June 9, 1992); Securities Exchange Act Release No. 27938 (Apr. 23, 1990), 55 FR 17949, 17950 (Apr. 30, 1990). The Commission adopted a narrow exception to Regulation SHO's "locate" requirement only for market makers engaged in bona-fide market making in the security at the time they effect the short sale. *See* 17 CFR

imposed certain restrictions on a DMM unit's trading in assigned securities, but those restrictions, according to the Exchange, may cause a conflict with a DMM unit's obligations to its customer when representing that customer's order as principal. The Commission believes that the proposal is reasonably designed to permit DMM units to comply with their obligations when engaging in proprietary trading on the Exchange in assigned securities, while also allowing a DMM unit to comply with customer instructions and the duty of best execution when representing customer orders as principal.

The Commission also notes that the Exchange's proposal includes certain safeguards that should help to prevent potential mismarking of orders as "customer-driven orders" and to assist the Exchange in monitoring for compliance by DMM units with Rule 98 as amended. The Commission notes that, under the proposal, all proprietary interest entered into Exchange systems by the DMM unit in DMM securities will be considered DMM unit interest unless that interest is (1) for the purpose of facilitating the execution of an order that has already been received from a customer (whether the DMM unit's own customer or the customer of another broker-dealer); and (2) represented on a riskless principal basis, or on a principal basis to provide price improvement to the customer. Moreover, the Commission notes that a DMM unit must use a unique mnemonic that identifies to the Exchange its customer-driven orders in DMM securities.

Finally, the Commission notes that the Exchange represents that this proposed rule change would not alter in any way a member organization's existing obligations under Section 15(g) of the Act,¹⁸ Regulation SHO,¹⁹ NYSE Rule 5320, or to maintain policies and procedures to ensure that a member organization does not engage in any frontrunning of customer order information in violation of Exchange, FINRA, or federal securities laws.

For the above reasons, the Commission finds that the proposal, as modified by Amendment No. 1, is consistent with the requirements of the Act.

IV. Solicitation of Comments on Amendment No. 1

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 to

the proposed rule 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. Please include File Number SR-NYSE-2016-16 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 Number SR-NYSE-2016-16. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSE-2016-16 and should be submitted on or before May 23, 2016.

V. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1, prior to the 30th day after the date of publication of notice of Amendment No. 1 in the **Federal Register**. In Amendment No. 1, the Exchange proposes: (1) To clarify that a DMM unit

must have received a customer order before it enters a "customer-driven order" in DMM securities at the Exchange; (2) to specify that a DMM unit entering a customer-driven order in DMM securities may do so only if the order is entered on a riskless principal basis or if the order is entered on a principal basis to provide price improvement to the customer; and (3) to provide that a mnemonic used to identify a DMM's customer-driven orders in DMM securities may not be used for trading activity at the Exchange in DMM securities that are not customer-driven order, but may be used for trading activities in securities not assigned to the DMM.

The Commission believes that the revisions proposed in Amendment No. 1 are designed to prevent abuse and facilitate surveillance of the new rules. Therefore, the Commission finds that Amendment No. 1 is consistent with the protection of investors and the public interest.

Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,²⁰ to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²¹ that the proposed rule change (NYSE-2016-16), as modified by Amendment No. 1, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²²

Robert W. Errett,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

Proposed Collection; Comment Request

Upon Written Request, Copies Available From: Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE., Washington, DC 20549-2736

Extension: Rule 6a-3, File No. 270-0015, OMB Control No. 3235-0021

Notice is hereby given that pursuant to the Paperwork Reduction Act of 1995 ("PRA") (44 U.S.C. 3501 *et seq.*), the Securities and Exchange Commission

¹⁸ 15 U.S.C. 78o(g).

¹⁹ 17 CRF 242.201.

²⁰ 15 U.S.C. 78s(b)(2).

²¹ *Id.*

²² 17 CFR 200.30-3(a)(12).