

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-84515; File No. SR-NYSE-2018-34)

November 1, 2018

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend NYSE Rule 104 Governing Transactions by Designated Market Makers

I. INTRODUCTION

On July 31, 2018, 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 104 governing transactions by Designated Market Makers (“DMMs”). The proposed rule change was published for comment in the Federal Register on August 16, 2018.³ On September 24, 2018, the Commission extended to November 14, 2018, the time period in which to approve, disapprove, or institute proceedings to determine whether to approve or disapprove, the proposal.⁴ The Commission has received no comments on the proposal. This order institutes proceedings under Section 19(b)(2)(B) of the Act⁵ to determine whether to approve or disapprove the proposal.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 83821 (Aug. 10, 2018), 83 FR 40808 (Aug. 16, 2018) (“Notice”).

⁴ See Securities Exchange Act Release No. 84276 (Sept. 24, 2018), 83 FR 49143 (Sep. 28, 2018).

⁵ 15 U.S.C. 78s(b)(2)(B).

II. SUMMARY OF THE PROPOSED RULE CHANGE

The Exchange proposes to amend NYSE Rule 104, which governs the dealings and responsibilities of Designated Market Makers (“DMMs”) on the Exchange.⁶ According to the Exchange, the proposal would consolidate and restructure current Rules 104(g), (h), and (i), which would be deleted and incorporated into a new subsection (g) titled “Transactions by DMMs.”⁷

Rule 104 currently defines four types of DMM transactions. Current Rule 104(g) defines Neutral Transactions, Non-Conditional Transactions, and Prohibited Transactions, and current Rule 104(h) defines Conditional Transactions.⁸ The Exchange proposes to eliminate the definitions of Neutral Transactions, Non-Conditional Transactions, and Prohibited Transactions and to amend the rules regarding Conditional Transactions and rename them “Aggressing Transactions” under an amended Rule 104(g).⁹

The Exchange proposes to define an Aggressing Transaction in proposed Rule 104(g)(1)(A) as a DMM unit transaction that is (1) a purchase (sale) that reaches across the market to trade as the contra-side to the Exchange published offer (bid); and (2) priced above (below) the last differently-priced trade on the Exchange and above (below) the last differently-priced published offer (bid) on the Exchange.¹⁰ According to the Exchange, under proposed Rule 104(g)(1)(B), an Aggressing Transaction during the last ten seconds prior to the scheduled close of trading that would result in a new consolidated high (low) price for a security during that

⁶ Details of the proposal rule change can be found in the Notice. See Notice, supra note 3.

⁷ See id. at 40809–10.

⁸ See id. at 40808–09 (describing current provisions regarding these transaction types).

⁹ See id. at 40809–10.

¹⁰ See id. at 40810.

trading day would be prohibited, unless the transaction would bring the price of the security into parity with an underlying or related security or asset.¹¹

According to the Exchange, proposed Rule 104(g)(2)—“Re-Entry Obligations”—would provide that the DMM unit’s obligation to maintain a fair and orderly market may require re-entry on the opposite side of the market after effecting one or more transactions.¹² According to the Exchange, proposed Rule 104(g)(2) would provide that this re-entry should be commensurate with the size of the transactions and the immediate and anticipated needs of the market, and the Exchange states that these are the same requirements currently specified for Neutral and Non-Conditional Transactions and for certain Conditional Transactions.¹³

Proposed Rule 104(g)(2)(A) would require that, after an Aggressing Transaction, a DMM unit must re-enter the opposite side of the market at or before the applicable Price Participation Point—which would be defined in proposed Rule 104(g)(3)—for that security, commensurate with the size of the Aggressing Transaction.¹⁴ Proposed Rule 104(g)(2)(B) would require that, following an Aggressing Transaction that is 10,000 shares or more or has a market value of \$200,000 or more and exceeds 50% of the published offer (bid) size, the DMM unit must immediately re-enter the opposite side of the market at or before the applicable Price Participation Point for that security commensurate with the size of the Aggressing Transaction.¹⁵

According to the Exchange, under proposed Rule 104(g)(3)(A), the Exchange would periodically issue Price Participation Point guidelines that identify the price at or before which a

¹¹ See id.

¹² See id. at 40811.

¹³ See id.

¹⁴ See id.

¹⁵ See id.

DMM unit is expected to re-enter the market following an Aggressing Transaction.¹⁶ Proposed Rule 104(g)(3)(A) would also provide that , the Price Participation Points are only minimum guidelines and compliance with them does not guarantee that a DMM unit is meeting its obligations.¹⁷

Proposed Rule 104(g)(3)(B) would provide that, notwithstanding that a security may not have reached the Price Participation Point, the DMM unit may be required to re-enter the market immediately after an Aggressing Transaction based on the price and/or volume of the DMM unit's trading in reference to the market in the security at the time of the trading.¹⁸ In such situations, proposed Rule 104(g)(3)(B) would state, DMM units may or may not rely on the fact and circumstance that there may have been one or more independent trades following the DMM unit's trading to justify a failure to re-enter the market.¹⁹

III. PROCEEDINGS TO DETERMINE WHETHER TO APPROVE OR DISAPPROVE THE PROPOSED RULE CHANGE AND GROUNDS FOR DISAPPROVAL UNDER CONSIDERATION

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act²⁰ to determine whether the proposal should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the proposal, as discussed below. Institution of disapproval proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described in greater detail

¹⁶ See id. at 40812.

¹⁷ See id.

¹⁸ See id.

¹⁹ See id.

²⁰ 15 U.S.C. 78s(b)(2)(B).

below, the Commission seeks and encourages interested persons to provide additional comment on the proposal.

Pursuant to Section 19(b)(2)(B) of the Act, the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposed rule change's consistency with Section 6(b)(5) of the Act,²¹ which requires that the rules of an 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, in general, to protect investors and the public interest, and which prohibits the rules of an exchange from being designed to permit unfair discrimination between customers, issuers, brokers, or dealers, and with Section 6(b)(8) of the Act, which requires that the rules of an exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

IV. SOLICITATION OF COMMENTS

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the concerns identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposal is inconsistent with Section 6(b)(5) or any other provisions of the Act, or the rules and regulation thereunder. Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral

²¹ 15 U.S.C. 78f(b)(5).

presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.²²

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

In particular, the Commission is interested in public comment on the following topics.

1. What are commenters' views regarding the Exchange's proposal to replace the existing rule against Prohibited Transactions, which is in effect during the last 10 minutes of trading, with the proposed prohibition of Aggressing Transactions during the last 10 seconds of trading that would result in a new consolidated high (low) price for a security during that trading day?²³

2. Do commenters believe that a prohibition against Aggressing Transactions during the last 10 second of trading that would result in a new consolidated high (low) price for a security during that trading day would be sufficient to prevent DMMs from aggressively taking liquidity and moving prices on the Exchange immediately before the closing auction? Why or why not? What are commenters' views on the trading statistics offered by the Exchange to

²² Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

²³ As noted above, such transaction would be permitted if they would bring the price of the security into parity with an underlying security or asset. See supra note 11 & accompanying text.

support its proposal to prohibit Aggressing Transactions only during the last 10 seconds of trading?²⁴ Do commenters believe that a different duration for such a prohibition would be preferable? If so, what duration and why?

3. What are commenters' views on the significance of the proposed change from the current prohibition against certain transactions that would set a new high or low price on the Exchange for the day to the proposed prohibition against certain transactions that would result in a new consolidated high or low price for the day? Do commenters believe that this change would have additional consequences for the operation of Rule 104?

4. What are commenters' views on how the obligations imposed on DMMs by proposed NYSE Rule 104 during the rest of the trading day would compare with the obligations imposed by current NYSE Rule 104?

5. What are commenters' views on the Exchange's argument that changes to NYSE Rule 104 would promote aggressive DMM quoting in their assigned securities? What are commenters' views on the Exchange's argument that DMMs are currently at a competitive disadvantage because of NYSE Rule 104 and that the current rule "thwarts the ability of the DMM to meet their affirmative obligations to quote aggressively in assigned securities"?

6. What are commenters' views on whether the "Price Participation Points" that the Exchange provides to its DMMs would be sufficient under the proposed changes to NYSE Rule 104 to prevent DMMs from aggressively taking liquidity and moving prices on the Exchange immediately before the closing auction?

7. Existing Rules 104(g) and (h) refer to "DMMs," and proposed Rule 104(g) would refer instead to "DMM units." What are commenters' views of the significance, if any, of this

²⁴ See Notice, supra note 3, 83 FR 40813, nn.14 & 18.

change in wording? What are commenters' views on whether the amended rule should apply to the activities of individuals trading as DMMs on the Exchange floor?

8. Generally, would the Exchange's proposal maintain an appropriate balance between the benefits and obligations of being a DMM on the Exchange?²⁵ In light of DMMs' special responsibility for closing auctions under NYSE rules, would the obligations of DMMs under NYSE rules be reasonably designed to prevent DMMs from inappropriately influencing or manipulating the close if the proposed rule change were approved?

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 e-mail to rule-comments@sec.gov. Please include File Number SR-NYSE-2018-34 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSE-2018-34. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

²⁵ Current NYSE Rule 104 was originally approved as part of the NYSE pilot program called the "New Market Model." See Securities Exchange Act Release No. 58845 (Oct. 24, 2008), 73 FR 64379 (Oct. 29, 2008). As the Commission stated when approving the NYSE's proposal to conduct the New Market Model pilot, "[w]e carefully review trading rule proposals that seek to offer special advantages to market makers. Although an exchange may reward such participants for the benefits they provide to the exchange's market, such reward must not be disproportionate to the services provided." See *id.* In 2015, the Commission permanently approved the New Market Model pilot and noted that the pilot had been conducted to seek "further evidence that the benefits proposed for DMMs are not disproportionate to their obligations." See Securities Exchange Act Release No. 75578 (July 31, 2015), 80 FR 47008 (Aug. 6, 2015).

comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<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 website 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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSE-2018-34 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁶

Eduardo A. Aleman
Assistant Secretary

²⁶ 17 CFR 200.30-3(a)(57).