

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-77838; File No. SR-NYSE-2016-33)

May 16, 2016

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Adopting New NYSE Rules 2090 (Know Your Customer) and 2111 (Suitability) that are Substantially Similar to FINRA Rules 2090 and 2111 and Deleting Current Rule 405 and the Related NYSE Rule Interpretation to Harmonize its Rules with Certain Financial Industry Regulatory Authority, Inc. Rules

Pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (the “Act” or “Exchange Act”)<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> notice is hereby given that on May 3, 2016, New York Stock Exchange LLC (“NYSE” or the “Exchange”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes: (1) adopting new NYSE Rules 2090 (Know Your Customer) and 2111 (Suitability) that are substantially similar to FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability); (2) deleting current Rule 405 (Diligence as to Accounts) and the related NYSE Rule Interpretation in order to harmonize its rules with certain Financial Industry Regulatory Authority, Inc. (“FINRA”) rules; and (3) making other conforming changes. The proposed rule change is available on the Exchange’s website at [www.nyse.com](http://www.nyse.com), at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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<sup>1</sup> 15 U.S.C.78s(b)(1).

<sup>2</sup> 15 U.S.C. 78a.

<sup>3</sup> 17 CFR 240.19b-4.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend its rules to harmonize with certain FINRA rules. Specifically, the Exchange proposes: (1) adopting new NYSE Rules 2090 and 2111 that are substantially similar to FINRA Rules 2090 and 2111; (2) deleting Rule 405<sup>4</sup> and the related NYSE Rule Interpretation; and (3) making other conforming changes.

Background

In 2007, the Exchange and FINRA<sup>5</sup> entered into an agreement (the “Agreement”) pursuant to Rule 17d-2 under the Act to reduce regulatory duplication by allocating to FINRA certain regulatory responsibilities for NYSE rules and rule interpretations (“FINRA Incorporated

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<sup>4</sup> References to “Rules” are to NYSE Rules unless otherwise indicated.

<sup>5</sup> NYSE Regulation, Inc., a former not-for-profit subsidiary of the Exchange, was also a party to the Agreement by virtue of the fact that it performed regulatory functions for the Exchange pursuant to a delegation agreement. See Exchange Act Release No. 53382 (Feb. 27, 2006), 71 FR 11251, 11264-65 (Mar. 6, 2006) (SR-NYSE-2005-77) (approving delegation agreement). The delegation agreement terminated on February 16, 2016, and NYSE Regulation has ceased providing regulatory services to the Exchange, which has re-integrated its regulatory functions.

NYSE Rules”).<sup>6</sup> In order to reduce regulatory duplication and relieve firms that are both members of the Exchange and FINRA of conflicting or unnecessary regulatory burdens, FINRA has been reviewing and amending the NASD and FINRA Incorporated NYSE Rules in order to create a consolidated FINRA rulebook.<sup>7</sup> NYSE MKT LLC (“NYSE MKT”) became a party to the Agreement effective December 15, 2008.<sup>8</sup>

As part of the rule consolidation process, in 2010, FINRA harmonized NASD and FINRA Incorporated NYSE Rules and interpretations concerning know your customer and suitability.<sup>9</sup> In its filing, FINRA: (1) adopted FINRA Rules 2090 (Know Your Customer) and 2090 (Suitability); and (2) deleted NASD Rule 2310 (Recommendations to Customers (Suitability)), NYSE Rule 405 (Diligence as to Accounts), and NYSE Rule Interpretations 405/01 through /04. The rule change was effective July 9, 2012.<sup>10</sup>

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<sup>6</sup> See Exchange Act Release Nos. 56148 (July 26, 2007), 72 FR 42146 (Aug. 1, 2007) (order approving the Agreement); 56147 (Jul. 26, 2007), 72 FR 42166 (Aug. 1, 2007) (SR-NASD-2007-054) (order approving the incorporation of certain NYSE Rules as “Common Rules”). Paragraph 2(b) of the Agreement sets forth procedures regarding proposed changes by FINRA or the Exchange to the substance of any of the Common Rules.

<sup>7</sup> FINRA’s rulebook currently has three sets of rules: (1) NASD Rules; (2) FINRA Incorporated NYSE Rules; and (3) consolidated FINRA Rules. The FINRA Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”), while the consolidated FINRA Rules apply to all FINRA members. For more information about the FINRA rulebook consolidation process, see FINRA Information Notice, March 12, 2008.

<sup>8</sup> See Exchange Act Release No. 60409 (Jul. 30, 2009), 74 FR 39353 (Aug. 6, 2009) (order approving the amended and restated Agreement, adding NYSE MKT as a party). Paragraph 2(b) of the Agreement sets forth procedures regarding proposed changes by FINRA, NYSE or NYSE MKT to the substance of any of the Common Rules.

<sup>9</sup> See Exchange Act Release No. 63325 (Nov. 17, 2010), 75 FR 71479 (Nov. 23, 2010) (SR-FINRA-2010-039) (“FINRA Know Your Customer and Suitability Approval”).

<sup>10</sup> See FINRA Regulatory Notice 11-25 (May 2011). The original effective date was October 7, 2011.

Currently, the Exchange does not have separate rules for know your customer and suitability. Rather, Rule 405 (Diligence as to Accounts) requires every member organization, through a principal executive or a person or persons designated under the provisions of Rule 3110(a), to take certain actions relative to customers and customer accounts. First, Rule 405(1) requires member organizations to use “due diligence” to learn the “essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization and every person holding power of attorney over any account accepted or carried by such organization.” Second, Rule 405(2) requires member organizations to supervise diligently all accounts handled by registered representatives. Finally, Rule 405(3) requires persons designated by the member to be informed of the essential facts relative to the customer and to the nature of the proposed account prior to approving the opening of the account.

Supplementary Material .10 of Rule 405 discusses the requirement that firms know their customers and imposes specific knowledge and due diligence requirements in connection with the authority of third parties to act on behalf of customers that are legal entities, including margin accounts carried by a member organization for a non-member corporation, cash accounts carried for a non-member corporation, and agency accounts carried by a member organization.<sup>11</sup>

Supplementary Material .20 of Rule 405 refers to the requirements of Rule 4311 concerning the permitted allocation of responsibilities between introducing and carrying organizations.

Supplementary Material .30 cross references to Rule 414 (Index and Currency Warrants).<sup>12</sup>

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<sup>11</sup> As discussed below, the Exchange believes that Supplementary Material .10 of Rule 405 is redundant of Proposed Rule 2090 and Proposed Supplementary Material .01 thereof that would require firms to know the essential facts concerning every customer.

<sup>12</sup> Rule 414 provides that Rule 723 (Suitability) applies to recommendations in currency warrants, currency index warrants and stock index warrants. The Exchange proposes to replace the outdated references to Rule 723 with a reference to Proposed Rule 2111. The

### Proposed Rule Change

The Exchange proposes to delete current Rule 405 and the related NYSE Rule Interpretation, which are, in main part, either duplicative of, or do not align with, the proposed know your customer and suitability requirements discussed below, and adopt the text of FINRA Rules 2090 and 2111.<sup>13</sup>

### Proposed Rule 2090 (Know Your Customer)

Like FINRA Rule 2090, Proposed NYSE Rule 2090 would encompass the “main ethical standard” of Rule 405(1).<sup>14</sup> The proposed rule would require every “member organization through a principal executive or a person or persons designated under the provisions of Rule 3110(a)”<sup>15</sup> to use “reasonable diligence,” with regard to the opening and maintenance of every account, in order to know and retain the essential facts concerning every customer. The proposed supplementary material would define “essential facts” as those “required to (a) effectively service the customer’s account, (b) act in accordance with any special handling instructions for the account, (c) understand the authority of each person acting on behalf of the

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Exchange believes that the remaining cross references in Rule 405 are either no longer necessary or moot.

<sup>13</sup> The Exchange would also make the following technical and conforming changes: (1) substitute the term “member organization” for the term “member,” which appears in FINRA’s rules (see note 17, *infra*); (2) substitute the term “person associated with a member organization” for the term “associated person,” which appears in FINRA’s rules (see note 17, *infra*); (3) substitute the term “Exchange” for “FINRA”; (4) change certain cross-references to FINRA rules to cross-references to Exchange rules; and (5) add references to Proposed Rules 2090 and 2111 in Rule 3170 (Tape Recording of Registered Persons by Certain Firms).

<sup>14</sup> See FINRA Know Your Customer and Suitability Approval, 75 FR at 71480.

<sup>15</sup> This is the current formulation in Rule 405, which the Exchange proposes to retain. This formulation differs from that of FINRA Rule 2090, which does not require a member to fulfill its obligations under the rule “through a principal executive or a person or persons designated under the provisions of Rule 3110(a).”

customer, and (d) comply with applicable laws, regulations, and rules.”<sup>16</sup> The proposed rule would be identical to FINRA Rule 2090 except that the proposed rule would use the term “member organization” rather than the term “member,” as the terms have different meanings under the FINRA rules and the Exchange rules.<sup>17</sup>

#### Proposed Rule 2111 (Suitability)

Proposed Rule 2111, like its FINRA counterpart, would require a member organization or person associated with a member organization<sup>18</sup> to have a “reasonable basis” to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer. This assessment would be based on the information obtained through the

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<sup>16</sup> See Proposed Rule 2090.01. Like FINRA, the Exchange does not propose to incorporate the requirement in NYSE Rule 405(1) to learn the essential facts relative to “every order.” The Exchange agrees with FINRA that the application of existing order-handling rules renders this formulation unnecessary. See FINRA Know Your Customer and Suitability Approval, 75 FR at 71480. Further, the Exchange’s proposed suitability rule would also require members and member organizations and their associated persons to use reasonable diligence to understand the securities and strategies they recommend, further obviating the need for this language. See *id.*

<sup>17</sup> Under FINRA Rule 0160(b)(9), “member” means an organization that is a member of FINRA. NYSE’s equivalent term is “member organization.” See Rule 2(b)(i). Under NYSE Rule 2(a), the term “member” means a natural person associated with a member organization that has been approved by the Exchange and designated by such member organization to effect transactions on the floor of the Exchange or any facility thereof. A “member” is not a registered broker-dealer and does not have employees; only member organizations have employees. As noted below, for purposes of the proposed change, the Exchange proposes to continue using the phrase “person associated with a member organization” to indicate employees of a member organization for purposes of Proposed Rule 2111.

<sup>18</sup> As proposed, Rule 2111 is identical to FINRA Rule 2111 except that the Exchange proposes to use the phrase “member organization or person associated with a member organization” rather than “member or an associated person” to indicate the coverage of the rule. As discussed above, “member” and “member organization” have different meanings under the NYSE and FINRA rules, and under the NYSE’s rules only member organizations can have employees. See note 17, *supra*. The Exchange thus proposes to use the phrase “person associated with a member organization” to indicate employees of a member organization for purposes of Proposed Rule 2111.

reasonable diligence of the member organization or person associated with a member organization to ascertain the customer's investment profile, which includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member organization or person associated with a member organization in connection with such recommendation.<sup>19</sup> Like the FINRA rule, the proposed rule would explicitly cover a recommended investment strategy.<sup>20</sup> The proposed rule would exclude the following communications from the coverage of Proposed Rule 2111 as long as they do not include (standing alone or in combination with other communications) a recommendation of a particular security or securities:

- General financial and investment information, including (i) basic investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment, (ii) historic differences in the return of asset classes (e.g., equities, bonds, or cash) based on standard market indices, (iii) effects of inflation, (iv) estimates of future retirement income needs, and (v) assessment of a customer's investment profile;
- Descriptive information about an employer-sponsored retirement or benefit plan, participation in the plan, the benefits of plan participation, and the investment options available under the plan;

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<sup>19</sup> See Proposed Rule 2111(a). For institutional customers, the proposed rule would, like the FINRA rule, require that a member organization or person associated with a member organization have a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies, and is exercising independent judgment in evaluating recommendations. See Proposed Rule 2111(b). Institutional customers would also be required to affirmatively indicate that they are exercising independent judgment. See *id.*

<sup>20</sup> See FINRA Know Your Customer and Suitability Approval, 75 FR at 71481.

- Asset allocation models that are (i) based on generally accepted investment theory, (ii) accompanied by disclosures of all material facts and assumptions that may affect a reasonable investor’s assessment of the asset allocation model or any report generated by such model, and (iii) in compliance with FINRA Rule 2214 (Requirements for the Use of Investment Analysis Tools) if the asset allocation model is an “investment analysis tool” covered by FINRA Rule 2214; and
- Interactive investment materials that incorporate the above.<sup>21</sup>

Again, like its FINRA counterpart, the proposed rule would be composed of three main suitability obligations, as follows:

- The reasonable-basis suitability obligation, which requires a member organization or person associated with a member organization to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors;<sup>22</sup>
- The customer-specific suitability obligation, which requires that a member organization or person associated with a member organization have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer’s investment profile, as delineated in Proposed Rule 2111(a);<sup>23</sup> and

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<sup>21</sup> See Proposed Rule 2111.03.

<sup>22</sup> See Proposed Rule 2111.05(a). The proposed rule would clarify that, in general, what constitutes reasonable diligence will vary depending on, among other things, the complexity of and risks associated with the security or investment strategy and the member organization’s or person associated with a member organization’s familiarity with the security or investment strategy. Further, a member organization’s or person associated with a member organization’s reasonable diligence must provide the member organization or person associated with a member organization with an understanding of the potential risks and rewards associated with the recommended security or strategy. Finally, the proposed rule would specify that the lack of such an understanding when recommending a security or strategy violates the suitability rule. See generally id.

<sup>23</sup> See Proposed Rule 2111.05(b).

- The quantitative suitability obligation, which requires a member organization or person associated with a member organization who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Proposed Rule 2111(a).<sup>24</sup>

Proposed Rule 2111 would also prohibit a member organization or person associated with a member organization from recommending a transaction or investment strategy involving a security or securities or the continuing purchase of a security or securities or use of an investment strategy involving a security or securities unless the member organization or person associated with a member organization has a reasonable basis to believe that the customer has the financial ability to meet such a commitment.<sup>25</sup>

Finally, like the FINRA rule, Proposed Rule 2111 would provide an exemption to customer-specific suitability for institutional investors, who would be required to affirmatively indicate that they are exercising independent judgment in evaluating the recommendations of the member organization or person associated with a member organization on a trade-by-trade basis, on an asset-class-by-asset-class basis, or in terms of all potential transactions for its account.<sup>26</sup>

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<sup>24</sup> See Proposed Rule 2111.05(c). The proposed rule would provide that no single test defines excessive activity but that factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a member organization or person associated with a member organization has violated the quantitative suitability obligation. See id.

<sup>25</sup> See Proposed Rule 2111.06.

<sup>26</sup> See Proposed Rule 2111.07. Like the FINRA rule, the institutional-customer exemption would apply only if both parts of the two-part test are met: (1) there is a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, in general and with regard to particular transactions and investment

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>27</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>28</sup> in particular, because the proposed rule change would be consistent with and facilitate a governance and regulatory structure that is 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 regulating, clearing, settling, processing information with respect to, and 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 Exchange believes the proposed rule change is consistent with the Exchange's obligations under the Exchange Act to prevent fraudulent or manipulative acts and practices, and to promote just and equitable principles of trade, because the proposed rule would incorporate the FINRA "know your customer" rule and related suitability standards into the Exchange's rules. The "know your customer" and suitability obligations are critical to ensuring investor protection and fair dealing with customers.

Further, the Exchange believes that the proposed rule change supports the objectives of Section 6(b)(5) of the Act by providing greater harmonization between Exchange rules and FINRA rules of similar purpose, resulting in less burdensome and more efficient regulatory compliance. In particular, Exchange member organizations that are also FINRA members are

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strategies, and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating recommendations. See Proposed Rule 2111(b); FINRA Know Your Customer and Suitability Approval, 75 FR at 71481, n. 25.

<sup>27</sup> 15 U.S.C. 78f(b).

<sup>28</sup> 15 U.S.C. 78f(b)(5).

subject to NYSE Rule 405 and FINRA Rules 2090 and 2111, and harmonizing these rules by adopting proposed rules identical to FINRA Rules 2090 and 2111 would promote just and equitable principles of trade by providing greater harmonization between NYSE rules and FINRA rules of similar purpose by requiring the same standards for “know your customer” and suitability, resulting in less burdensome and more efficient regulatory compliance for Dual Members. As previously noted, the proposed rule text is substantially the same as FINRA’s rule text. To the extent the Exchange has proposed changes that differ from the FINRA version of the Exchange rules, such changes are technical in nature and do not change the substance of the proposed rules. The Exchange also believes that the proposed rule change will update and add specificity to the requirements governing “know your customer” and suitability requirements, which will promote just and equitable principles of trade and help to protect investors.

B. Self-Regulatory Organization's Statement on Burden on Competition

In accordance with Section 6(b)(8) of the Act,<sup>29</sup> the Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change is not intended to address competitive issues but rather to achieve greater consistency between the Exchange’s rules and FINRA’s rules concerning “know your customer” and suitability.

C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The Exchange has filed the proposed rule change pursuant to Section 19(b)(3)(A)(iii) of

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<sup>29</sup> 15 U.S.C. 78f(b)(8).

the Act<sup>30</sup> and Rule 19b-4(f)(6) thereunder.<sup>31</sup> Because the proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative prior to 30 days from the date on which it was filed, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of the filing.<sup>32</sup> However, pursuant to Rule 19b-4(f)(6)(iii), the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest.<sup>33</sup>

At any time within 60 days of the filing of such proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings under Section 19(b)(2)(B)<sup>34</sup> of the Act to determine whether the proposed rule change should be approved or disapproved.

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<sup>30</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>31</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

<sup>32</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>33</sup> Id.

<sup>34</sup> 15 U.S.C. 78s(b)(2)(B).

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NYSE-2016-33 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-2016-33. This file number should be included on the subject line if e-mail 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 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; 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-2016-33 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>35</sup>

Robert W. Errett  
Deputy Secretary

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<sup>35</sup> 17 CFR 200.30-3(a)(12).