

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71620; File No. SR-NYSE-2014-02)

February 27, 2014

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Granting Approval of Proposed Rule Change Amending Supplementary Material .20 to NYSE Rule 103 Setting Forth Net Liquid Assets Requirements for Member Organizations that Operate as Designated Market Maker Units

I. Introduction

On January 6, 2014, the New York Stock Exchange LLC (the “Exchange” or “NYSE”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to amend Supplementary Material .20 to NYSE Rule 103 (“NYSE Rule 103.20” or the “Rule”), which sets forth net liquid asset requirements for NYSE member organizations that operate as Designated Market Maker (“DMM”) units. The proposed rule change was published for comment in the Federal Register on January 27, 2014.³ The Commission received no comments in response to the proposal. This order approves the proposed rule change.

II. Description of the Proposal

The Exchange proposes to amend NYSE Rule 103.20, which sets forth net liquid assets requirements for member organizations that operate as DMM units.⁴ Specifically, the Exchange proposes to change the types of financial assets and resources that would be allowed to fulfill the net

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 71360 (January 21, 2014), 79 FR 4366 (“Exchange’s Notice”).

⁴ Pursuant to NYSE Rule 2(j), a DMM unit is defined as a member organization or unit within a member organization that has been approved to act as a DMM unit under NYSE Rule 98. Pursuant to NYSE Rule 2(i), a DMM is defined as an individual member, officer, partner, employee, or associated person of a DMM unit who is approved by the Exchange to act in the capacity of a DMM.

liquid assets requirement of NYSE Rule 103.20 and to reorganize and add detail to the rule so that it is easier to understand.

Current Rule

Under NYSE Rule 103.20, the Exchange imposes a net liquid assets requirement on each DMM unit that typically exceeds minimum net capital requirement applicable to a broker-dealer pursuant to Rule 15c3-1 under the Act.⁵ The Exchange indicates that the purpose of the rule is to reasonably assure that each DMM unit maintains sufficient liquidity to carry out its obligation to maintain an orderly market in its assigned securities in times of market stress. The Exchange established the formula for the current net liquid assets requirement in July 2011.⁶ Under current NYSE Rule 103.20, each DMM unit must maintain or have allocated to it net liquid assets that are the greater of (1) \$1 million or (2) \$125,000 for each one-tenth of one percent (0.1%) of Exchange transaction dollar volume⁷ in its registered securities that are not exchange-traded funds (“ETFs”), plus a market risk add-on of the average of the prior 20 business days’ securities haircuts on its DMM dealer’s positions computed pursuant to certain parts of Rule 15c3-1 under the Act (the “Market Risk Add-on Charge”).⁸ DMM units registered in ETFs must maintain the greater of \$1 million or \$500,000 for each ETF.⁹ A DMM unit must inform NYSE Regulation immediately whenever the DMM unit is unable to comply with the requirements under the Rule.

⁵ 17 CFR 240.15c3-1.

⁶ See Securities Exchange Act Release No. 64918 (July 19, 2011), 76 FR 44390 (July 25, 2011) (SR-NYSE-2011-35).

⁷ The term “Exchange transaction dollar volume” means the most recent statistical data, calculated and provided by the NYSE on a monthly basis. See NYSE Rule 103.20(b)(iii).

⁸ The Market Risk Add-on Charge is computed using the average of the prior twenty business days’ securities haircuts on its DMM dealer’s positions computed pursuant to Rule 15c3-1(c)(2)(vi), exclusive of paragraphs (N), under the Act. See NYSE Rule 103.20(b)(i)(B).

⁹ See NYSE Rule 103.20(b)(i)(A).

The term “net liquid assets” is currently defined as excess net capital computed in accordance with the Rule 15c3-1 under the Act and NYSE Rule 325,¹⁰ with the certain adjustments.¹¹ Solely for the purpose of maintaining a fair and orderly market, NYSE Regulation may, for a period not to exceed five business days, allow a DMM unit to continue to operate despite such DMM unit’s noncompliance with the provisions of the minimum requirements of NYSE Rule 103.20.

Developments Since July 2011 Rule Implementation

In the Exchange’s filing, it noted many factors that have arisen since July 2011, when the Exchange originally established the formula for the net liquid asset requirements for DMM units that would support modifying the DMM units’ capital requirements. These factors, which included legal and regulatory developments, market fragmentation, DMM unit end-of-day inventory positions and position duration, and the use of technology to manage market volatility are described in more detail in the Exchange’s Notice.¹²

Proposed Rule Change

The Exchange proposed to amend the NYSE Rule 103.20 to expand the types of financial assets and resources permitted to be used by a DMM unit to meet the minimum “Net Liquid Assets” requirement without changing the aggregate level of Net Liquid Assets required for all

¹⁰ The Commission notes that NYSE Rule 325 was deleted and replaced by FINRA Rule 4110. See Exchange Act Release No. 61557 (February 22, 2010), 75 FR 9472 (March 2, 2010) (SR-NYSE-2010-10).

¹¹ The adjustments are as follows: (A) Additions for haircuts and undue concentration charges taken pursuant to paragraph (c)(2)(vi)(M) of Rule 15c3-1 under the Act on registered securities in dealer accounts; (B) Deductions for clearing organization deposits; and (C) Deductions for any cash surrender value of life insurance policies allowable under Rule 15c3-1 under the Act. See NYSE Rule 103.20(a)(iv).

¹² See supra note 3.

DMM units. Specifically, the proposal would permit some of DMM unit's Net Liquid Assets¹³ to be comprised of "Liquidity," which would be defined to include certain undrawn committed lines of credit and actual borrowings that are used to purchase DMM unit securities, U.S. Treasuries, or reverse repurchase agreements or that are held as cash.¹⁴ A DMM unit would be limited in the percentage of Net Liquid Assets that could be comprised of Liquidity. Specifically, a DMM unit would be required to derive at least 40% of its total required Net Liquid Assets with "Excess Net Capital" (defined as excess net capital computed in accordance with Rule 15c3-1 under the Act) that is dedicated exclusively to the DMM unit's activities.¹⁵ In effect, this requirement would limit the percentage of a DMM unit's Net Liquid Assets to be comprised of no more than 60% in Liquidity.

The Liquidity that would be eligible to be included in a Net Liquid Assets would also be subject to additional requirements. For example, all Liquidity would be required to be subject to a minimum level of commitment period (of not less than 30 calendar days), and a minimum initial repayment term of not less than 30 calendar days.¹⁶ Moreover, the Liquidity would be required to be included in a comprehensive liquidity plan that provides for stress testing of the Liquidity that must show, among other things, that there would be excess Liquidity available to the DMM unit for 30 calendar days beyond the date of the Net Liquid Assets computation.¹⁷

The Exchange also proposes to eliminate the separate, additional financial requirement for ETFs.¹⁸ In justifying the elimination of these additional requirements for ETFs, the

¹³ See proposed NYSE Rule 103.20(a)(1).

¹⁴ See proposed NYSE Rule 103.20(a)(3).

¹⁵ See proposed NYSE Rule 103.20(b)(2).

¹⁶ See proposed NYSE Rule 103.20(a)(4).

¹⁷ See proposed NYSE Rule 103.20(a)(5).

¹⁸ See NYSE Rule 103.20(a)(ii).

Exchange indicated that it believes that DMM units should be subject to the same Net Liquid Assets Requirements for ETFs as for other securities and notes that if a DMM unit were assigned a significant number of ETFs, the Net Liquid Assets Requirement for those ETFs would significantly exceed the Net Liquid Assets Requirement applicable to an equal number of other securities.¹⁹

The proposed rule change would also eliminate the Market Risk Add-on Charge,²⁰ as well as the adjustments to the Net Liquid Assets described above.²¹ In addition, the proposal would require written approval by NYSE Regulation for any joint account involving two or more DMM units.²²

The proposed rule change would delineate the circumstances where a DMM unit must notify NYSE Regulation, or its designee, immediately.²³ The proposal also would maintain the Exchange's flexibility to allow a DMM unit to continue to operate as a DMM for a limited period of time (of no more than five business days) when the DMM unit fails to meet the requirements of NYSE Rule 103.20, and clarifies that a DMM unit that is granted permission by

¹⁹ The Exchange further notes that the current ETF financial requirements date back to a time when the overall financial requirements for specialists (predecessors to DMM units) were significantly higher, and have not been modernized to account for a changing micro and macro market structure, despite decreases in the financial requirements applicable to other securities. See Securities Exchange Act Release No. 54205 (July 25, 2006), 71 FR 43260 (July 31, 2006) (SR-NYSE-2005-38).

²⁰ See note 8 supra.

²¹ See note 11 supra.

²² See proposed NYSE Rule 103.20(b)(3).

²³ Specifically, a DMM unit would be required to notify NYSE Regulation when: (A) the DMM unit's Net Liquid Assets fall below the minimum requirements; (B) the percentage of Net Liquid Assets derived from the DMM unit's Excess Net Capital falls below 40% of the total Net Liquid Assets requirement; (C) Liquidity has a commitment term of less than 30 calendar days from the date of the DMM unit's Net Liquid Assets computation; (D) the DMM unit is not in compliance with one or more terms of its loan or commitment agreements relating to its DMM activities; or (E) The repayment date of any actual borrowing is 30 days or less.

See proposed NYSE Rule 103.20(c)(1).

NYSE Regulation to continue to operate for up to five business days may continue to operate as such thereafter if the DMM unit resolves the condition within the period of time granted by NYSE Regulation.

The Exchange believes that the proposed change would result in DMM units maintaining a robust level of capital through a means that is less burdensome for DMM units to satisfy. The Exchange notes that it would continue to assess DMM unit financial requirements and that the Financial Industry Regulatory Authority, Inc. (“FINRA”), on behalf of the Exchange, would monitor DMM unit Net Liquid Assets on a daily basis.²⁴ The Exchange would notify DMM units of the implementation date of this rule change via a Member Education Bulletin.

III. Discussion of Commission Findings

After careful review and for the reasons discussed below, the Commission finds that the proposed rule change is consistent with the requirements of the Act, including Section 6 of the Act,²⁵ and the rules and regulations thereunder applicable to a national securities exchange.²⁶ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,²⁷ 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, and, in general, to protect investors and the public interest, to

²⁴ See NYSE Rule 0 (describing the regulatory services agreement between NYSE and FINRA). In particular, FINRA would monitor actual DMM unit borrowings after the effective date of the proposed rule to assess whether proceeds have been used to purchase DMM unit securities, U.S. Treasury securities, or reverse repurchase agreements collateralized by U.S. Treasury securities, or are held as cash. This could be accomplished, for example, by comparing the timing of the borrowings to the timing of a DMM unit’s purchases of the corresponding assets.

²⁵ 15 U.S.C. 78f.

²⁶ 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).

²⁷ 15 U.S.C. 78f(b)(5).

facilitate transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

The Commission believes that the expansion of the the types of assets that will be available for a DMM unit to include in its Net Liquid Assets requirement should facilitate a DMM unit's ability to meet the minimum capital requirements imposed by the Exchange, thus removing impediments to a free and open market. The proposal's requirement that a DMM unit derive at least 40% of its total required Net Liquid Assets with Excess Net Capital appears to be reasonably designed to protect investors and the public interest because the Rule will continue to require that a DMM unit hold a portion of capital that is derived from sources recognized by the Commission as allowable for a broker-dealer to meet its minimum net capital requirement.²⁸ In making this finding, the Commission notes that the Exchange represented in its filing that it believes that the 40% level exceeds the amount of capital that historical DMM unit losses have required. The Commission also believes that the proposal's delineation of the circumstances under which a DMM unit must immediately notify NYSE Regulation, such as when its Net Liquid Assets fall below the minimum threshold of the Rule, is reasonably designed to protect investors and the public interest and prevent fraudulent and manipulative acts and practices.

The Commission also believes that the Exchange's removal of the Market Risk Add-on Charge and the elimination of the deductions for clearing organization deposits and the cash surrender value of certain life insurance policies is also reasonably designed to facilitate transactions in securities and perfect the mechanism of a free and open market. In its filing, the Exchange noted that the overall DMM unit risk levels have declined since the original implementation of NYSE Rule 103.20, the overall consolidated Tape A volume as well as the

²⁸ See Rule 15c3-1 under the Act.

Exchange's average daily volume of shares traded have declined approximately 30% since 2010, the average value of DMM units' end-of-day position inventories have decreased by over half since the last time the Exchange filed to amend the DMM net capital requirements, and the duration of a DMM unit's position is much shorter than it was in years past. The Commission believes that these factors support the Exchange's rationale for changing the Rule.

The Commission also believes that harmonizing the financial requirements applicable to DMM units responsible for ETFs with the requirements applicable to DMM units responsible for other securities promotes just and equitable principles of trade. The Exchange represented that it does not currently list or trade ETFs, and that the enhanced financial requirements for DMM units responsible for ETFs date back to a time when the overall financial requirements for specialists (predecessors to DMM units) were significantly higher, and have not been modernized to account for a changing micro and macro market structure, despite decreases in the financial requirements applicable to other securities.

The Commission also finds that the proposed rule change is consistent with Section 6(b)(8) of the Act,²⁹ which requires that the rules of a national securities exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The Commission believes that the easing of financial requirements for DMM units should promote competition in that it will permit a greater number of broker-dealers to qualify as DMMs while still providing assurances that DMMs have the financial wherewithal to undertake the responsibilities that attend to such a role. Finally, the conditions under which a DMM unit must notify NYSE Regulation under the proposal appear to be narrowly tailored to meet the objective of keeping NYSE Regulation informed of financially troubled DMM units.

²⁹ 15 U.S.C. 78f(b)(8).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³⁰ that the proposed rule change (SR-NYSE-2014-02) be, and it is hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³¹

Kevin M. O'Neill
Deputy Secretary

³⁰ 15 U.S.C. 78s(b)(2).

³¹ 17 CFR 200.30-3(a)(12).