

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-75432; File No. SR-NYSEMKT-2015-23)

July 13, 2015

Self-Regulatory Organizations; NYSE MKT LLC; Order Approving Proposed Rule Change, as Modified by Amendment No. 1, Adopting a Principles-Based Approach to Prohibit the Misuse of Material Nonpublic Information by Specialists and e-Specialists by Deleting Rule 927.3NY and Section (f) of Rule 927.5NY

I. Introduction

On April 8, 2015, NYSE MKT LLC (the “Exchange” or “NYSE MKT”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (“Act”)² and Rule 19b-4 thereunder,³ a proposed rule change adopting a principles-based approach to prohibit the misuse of material nonpublic information by Specialists and e-Specialists by deleting NYSE MKT Rule 927.3NY and Section (f) of NYSE MKT Rule 927.5NY. The proposed rule change was published for comment in the Federal Register on April 14, 2015.⁴ The Commission received one comment letter regarding the proposed rule change.⁵ On May 20, 2015, the Commission extended the time period in which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to July 13,

¹ 15 U.S.C. 78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

⁴ See Securities Exchange Act Release No. 74677 (April 8, 2015), 80 FR 20049 (“Notice”).

⁵ See Letter from Peter D. Selman, Managing Director, Goldman Sachs & Co., dated May 5, 2015 (“Goldman Letter”).

2015.⁶ On June 18, 2015, the Exchange filed Amendment No. 1 to the proposed rule change.⁷

This order approves the proposed rule change, as modified by Amendment No. 1.

II. Description of the Proposal

The Exchange proposes to delete NYSE MKT Rule 927.3NY, which sets forth prescriptive requirements for Specialists to have information barriers, and NYSE MKT Rule 927.5NY(f), which sets forth a principles-based, information barrier requirement for e-Specialists. NYSE MKT Rule 3(j), which requires that every Exchange member establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse

⁶ See Securities Exchange Act Release No. 75004 (May 20, 2015), 80 FR 30301 (May 27, 2015).

⁷ In Amendment No. 1 the Exchange clarifies that it is not proposing to change what is considered to be material, non-public information and, thus does not expect there to be any changes to the types of information that an affiliated brokerage business of a Specialist or e-Specialist could share with such Specialist or e-Specialist. In that regard, the Exchange explains that it no longer offers Reserve Orders, and the proposed rule change would not permit the affiliates of a Specialist or e-Specialist to have access to any non-public order or quote information of the Specialist or e-Specialist. The Exchange also explains that it does not believe that there will be any material change to member information barriers as a result of removal of the Exchange pre-approval requirement. In fact, the Exchange anticipates that eliminating the pre-approval requirement should facilitate implementation of changes to member information barriers as necessary to protect against the misuse of material, non-public information. The Exchange also suggests that the pre-approval requirement is unnecessary because Specialists no longer have agency responsibilities to the book, or time and place information advantages because of their market role. Finally, the Exchange argues that NYSE MKT Rule 927.5NY(f) is a principles-based information barrier rule that is redundant of the requirements applicable to all members under NYSE MKT Rule 3(j). Amendment No. 1 is not subject to notice and comment because it is a technical amendment that does not alter the substance of the proposed rule change or raise any novel regulatory issues. Amendment No. 1 has been placed in the public comment file for SR-NYSEMKT-2015-23 at <http://www.sec.gov/comments/sr-nysemkt-2015-23/nysemkt201523.shtml> (see letter from Martha Redding, Senior Counsel, Assistant Secretary, New York Stock Exchange LLC (“NYSE”), to Secretary, Commission, dated June 30, 2015) and also is available at the Exchange’s website at <https://www.nyse.com/regulation/rule-filings>.

of material, non-public information by such member or associated persons, would remain in effect and would continue to apply to both Specialists and e-Specialists.

Under NYSE MKT Rule 3(j), the misuse of material, non-public information includes, but is not limited to, the following:

- a) trading in any securities issued by a corporation, or in any related securities or related options or other derivative securities, while in possession of material, non-public information concerning that issuer;
- b) trading in a security or related options or other derivative securities, while in possession of material, non-public information concerning imminent transactions in the security or related securities; or
- c) disclosing to another person or entity any material, non-public information involving a corporation whose shares are publicly traded or an imminent transaction in an underlying security or related securities for the purpose of facilitating the possible misuse of such material, non-public information.

Pursuant to NYSE MKT Rule 3(j), Specialists and e-Specialists are obligated to ensure that their policies and procedures reflect the current state of their business and are reasonably designed to protect against the misuse of material, non-public information, applicable federal securities law and regulations, and Exchange rules. The Exchange believes that such a principles-based approach should provide Specialists, e-Specialists and ATP Holders with greater flexibility to develop and adapt their policies and procedures as appropriate to reflect their business model, business activities, or the securities market.⁸

The Exchange notes that under this proposed rule change an ATP Holder could structure its options Specialists, e-Specialists, or Market Makers, as applicable, with the firm's equities and customer-facing businesses; provided, that any such structuring be done in a manner

⁸ See Notice, supra note 4, 80 FR at 20050.

reasonably designed to protect against the misuse of material, non-public information.⁹ For example, the Exchange explains that pursuant to NYSE MKT Rule 3(j), a Specialist could be in the same independent trading unit, as defined in Rule 200(f) of Regulation SHO,¹⁰ as an equities market maker and other trading desks within the firm, including options trading desks, to facilitate the sharing of post-trade information for risk management purposes across related securities.¹¹ Further, consistent with NYSE MKT Rule 3(j) and Section 15(g) of the Act,¹² the Exchange notes that a firm with reasonably designed policies and procedures, including information barriers as applicable, to protect against the misuse of material non-public information, and specifically customer information, could share options position and related hedging position information (e.g., equities, futures, and foreign currency) within a firm to better manage risk on a firm-wide basis.¹³ The Exchange also notes that if Specialists or e-Specialists are integrated with other market making operations, they would be subject to existing Exchange rules that prohibit ATP Holders from disadvantaging their customers or other market participants by improperly capitalizing on a member organization's access to the receipt of material, non-public information.¹⁴ Nonetheless, the Exchange also notes that while the proposed rule change would no longer specifically require information barriers, an ATP Holder's business model or business activities may dictate that an information barrier or a functional separation be part of the

⁹ See id. at 20051.

¹⁰ 17 CFR 242.200(f).

¹¹ See Notice, supra note 4, 80 FR at 20051.

¹² 15 U.S.C. 78o(g).

¹³ See Notice, supra note 4, 80 FR at 20051.

¹⁴ See id. at 20051-52.

policies and procedures that are reasonably designed to achieve compliance with applicable securities law and regulations, and with applicable Exchange rules.¹⁵

Deleting NYSE MKT Rule 927.3NY will remove the requirement for specified, prescriptive information barriers as well as the pre-approval of any information barriers used by Specialists. Deleting NYSE MKT Rule 927.5NY(f) will remove the explicit information barrier requirement for e-Specialists. However, the Exchange notes, as is the case today with Market Makers, that information barriers of new entrants, including new Specialists, would be subject to review as part of a new firm application.¹⁶ Moreover, the policies and procedures of Specialists and e-Specialists, including those relating to information barriers, would be subject to review by the Financial Industry Regulatory Authority (“FINRA”), on behalf of the Exchange, pursuant to a Regulatory Services Agreement.¹⁷

The Exchange also represents that Specialists and e-Specialists do not have different or greater access to nonpublic information than other market participants on the Exchange, and differ from other types of Exchange Market Makers only because of heightened obligations and allocation guarantees.¹⁸ Specifically, the Exchange notes that Specialists and e-Specialists, like other types of Exchange Market Makers, do not have any agency responsibilities for orders in the Consolidated Book. Accordingly, the Exchange believes that it is appropriate to apply a consistent, principles-based, regulatory framework related to the protection against the misuse of material non-public information for Specialists, e-Specialists and Market Makers under NYSE MKT Rule 3(j).

¹⁵ See id. at 20052.

¹⁶ See id. at 20050-51, n. 7.

¹⁷ See id.

¹⁸ See Rules 927NY(c) and 927.5NY; see also Notice, supra note 4, 80 FR at 20050.

The Exchange also proposes to make a conforming amendment to remove references to NYSE MKT Rule 927.3NY from NYSE MKT Rule 927.6NY.

III. Summary of Comment Received

The Commission received one comment letter in support of the proposal.¹⁹ The commenter stated that Exchange Specialists no longer have informational advantages compared to other Exchange market participants, and thus the specific and rigid requirements applied to Specialists under NYSE MKT Rule 927.3NY and NYSE MKT Rule 927.5NY(f) are no longer meaningful.²⁰ In addition, the commenter posited that the proposal would promote effective risk management by enabling firms with multiple options trading desks to share proprietary options positions and related hedging position information.²¹ The commenter explained that many firms seek to centralize trading operations in order to eliminate redundancies, develop more resilient system architecture, and thereby reduce position risk.²² The commenter also opined that the proposed rule change is consistent with the Commission's efforts to require firms to more effectively limit exposure resulting from trading market risk.²³ Further, the commenter suggested that the Exchange's proposed approach to preventing the misuse of material non-public information be adopted by other option exchanges such that the benefits of the proposal could be fully realized.²⁴

¹⁹ See Goldman Letter, supra note 5.

²⁰ Id. at 1.

²¹ Id.

²² Id. at 2.

²³ Id.

²⁴ Id.

IV. Discussion and Commission Findings

After careful consideration, 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.²⁵ The Commission believes that the proposed rule change, as modified by Amendment No. 1, is consistent with Section 6(b)(5)²⁶ in particular, in that it 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 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 proposes to delete NYSE MKT Rule 927.3NY, which sets forth prescriptive requirements for Specialists to have information barriers, and NYSE MKT Rule 927.5NY(f), which sets forth a principles-based, information barrier requirement for e-Specialists. The Commission believes that the proposed rule change is consistent with the Act because it continues to require firms to maintain policies and procedures, consistent with NYSE MKT Rule 3(j) and Section 15(g) of the Act,²⁷ that are reasonably designed to prevent the misuse of material, non-public information, while allowing firms greater flexibility in structuring their business and compliance operations. Further, as noted by the Exchange in the Notice, if Specialists or e-Specialists are integrated with other market making operations, they would be subject to existing Exchange rules that prohibit ATP Holders from

²⁵ In approving this rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²⁶ 15 U.S.C. 78f(b)(5).

²⁷ 15 U.S.C. 78o(g). See Notice, supra note 4, 80 FR at 20051-52.

disadvantaging their customers or other market participants by improperly capitalizing on a member organization's access to the receipt of material, non-public information.²⁸ For example, NYSE MKT Rule 320 requires members to establish, maintain, enforce, and keep current a system of compliance and supervisory controls, reasonably designed to achieve compliance with applicable securities laws and Exchange rules, and NYSE MKT Rule 995NY(c) prevents an ATP Holder or person associated with an ATP Holder, who has knowledge of an originating order, a solicited order, or a facilitation order, to enter, based on such knowledge, an order to buy or sell an option on the underlying securities of any option that is the subject of the order, an order to buy or sell the security underlying any option that is the subject of the order, or any order to buy or sell any related instrument unless certain disclosure or timing requirements are satisfied.

The Commission notes that the Exchange has represented that Specialists and e-Specialists do not have informational advantages compared to other Exchange market participants.²⁹ The Commission additionally notes that the Exchange has specified that it no longer offers Reserve Orders, and, further specified that in no event would this proposed rule change permit the affiliates of a Specialist or e-Specialist to have access to any non-public quote or order information of the Specialist or of the e-Specialist.³⁰ Accordingly, based on the Exchange's representations that (1) Specialists and e-Specialists do not have informational advantages compared to other Exchange market participants, (2) Specialists and e-Specialists are not be permitted to share any hidden, non-public quote or order interest with an affiliate, and (3) ATP Holders are prohibited from disadvantaging their customers or other market participants by

²⁸ See Notice, supra note 4, 80 FR at 20051-52.

²⁹ See Amendment No. 1, supra note 7.

³⁰ See id.

improperly capitalizing on a member organization's access to the receipt of material, non-public information, the Commission believes that it is appropriate for the Exchange to adopt a principles-based regulatory approach.³¹ Nonetheless, the Commission notes that, while information barriers are not specifically required under this proposed rule change, a firm's business model or business activities may dictate that an information barrier or a functional separation be part of the appropriate set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities law and regulations, and with applicable Exchange rules.

Finally, the Commission notes that the policies and procedures required by NYSE MKT Rule 3(j) are subject to oversight by the Exchange and review by FINRA,³² and the Commission emphasizes that member organizations operating a Specialist, e-Specialist or Market Maker should be proactive in assuring that its policies and procedures reflect the current

³¹ In approving this rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f). The Commission notes that NYSE Arca Equities, Inc. ("NYSE Arca") and BATS Exchange, Inc.'s ("BATS"), cash equity markets that trade electronically, have both adopted a principles-based approach to protecting against the misuse of material non-public information. See Securities Exchange Act Release Nos. 60604 (Sept. 2, 2009), 76 FR 46272 (Sept. 8, 2009) (SR-NYSEArca-2009-78)("Arca Approval Order"); 61574 (Feb. 23, 2010), 75 FR 9455 (Mar. 2, 2010) (SR-BATS-2010-003)("BATS Approval Order"). Similarly, NYSE and NYSE MKT, except for prescribed rules relating to floor-based designated market makers that have access to specified non-public trading information, also adopted principles-based approaches to prevent the misuse of material non-public information for cash equity markets. See Securities Exchange Act Release Nos. 72534 (July 3, 2014), 79 FR 39019 (July 9, 2014)(SR-NYSE-2014-12)("NYSE Approval Order"); 72535 (July 3, 2014) 79 FR 39024 (July 9, 2014)(SR-NYSEMKT-2014-22)("NYSE MKT Approval Order").

³² See Notice, supra note 4, 80 FR at 20050-51, n. 7.

state of its business and continue to be reasonably designed to achieve compliance with applicable federal securities law and regulations and with applicable Exchange rules.³³

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act³⁴ that the proposed rule change (SR-NYSEMKT-2015-23), as modified by Amendment No. 1, be, and it hereby is, approved.

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

Brent J. Fields
Secretary

³³ The Commission notes that such policies and procedures may include the programming and operation of a member organization's trading algorithms to protect against the misuse of material non-public information.

³⁴ 15 U.S.C. 78s(b)(2).

³⁵ 17 CFR 200.30-3(a)(12).