

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-66397; File Nos. SR-NYSE-2011-56; SR-NYSEAmex-2011-86)

February 15, 2012

Self-Regulatory Organizations; New York Stock Exchange LLC; NYSE Amex LLC; Order Instituting Proceedings to Determine Whether to Disapprove Proposed Rule Changes to Codify Certain Traditional Trading Floor Functions That May Be Performed by Designated Market Makers and to Permit Designated Market Makers and Floor Brokers Access to Disaggregated Order Information

I. Introduction

On October 31, 2011, the New York Stock Exchange LLC (“NYSE”) and NYSE Amex LLC (“NYSE Amex”) (collectively, the “SROs”) each filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> proposed rule changes (the “SRO Proposals”) to amend certain of their respective rules relating to Designated Market Makers (“DMMs”)<sup>3</sup> and

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See NYSE Rule 98(b)(2). “DMM unit” means any member organization, aggregation unit within a member organization, or division or department within an integrated proprietary aggregation unit of a member organization that (i) has been approved by NYSE Regulation pursuant to section (c) of NYSE Rule 98, (ii) is eligible for allocations under NYSE Rule 103B as a DMM unit in a security listed on the Exchange, and (iii) has met all registration and qualification requirements for DMM units assigned to such unit. The term “DMM” means any individual qualified to act as a DMM on the Floor of the Exchange under NYSE Rule 103. See also NYSE Amex Equities Rule 2(i). Rule 2(i) defines the term “DMM” to mean 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. NYSE Amex Equities Rule 2(j) defines the term “DMM unit” as a member organization or unit within a member organization that has been approved to act as a DMM unit under NYSE Amex Equities Rule 98.

Floor brokers. The SRO Proposals were published for comment in the Federal Register on November 17, 2011.<sup>4</sup> The Commission received no comment letters on the proposals.

On December 22, 2011, the Commission extended the time period in which to either approve the SRO Proposals, disapprove the SRO Proposals, or to institute proceedings to determine whether to disapprove the SRO Proposals, to February 15, 2012.<sup>5</sup> This order institutes proceedings under Section 19(b)(2)(B) of the Act to determine whether to disapprove the SRO Proposals.

## II. Description of the Proposals

The SRO Proposals seek to amend the SROs' rules in several ways. First, the SROs propose to codify certain Trading Floor functions that may be performed by DMMs. Second, the SROs propose to allow DMMs to access Exchange systems that would provide DMMs with additional order information about the securities in which they are registered. Third, the SROs propose to make certain conforming amendments to their rules to reflect the additional order information that would be available to DMMs through Exchange systems, and to specify what information about e-Quotes is available to the DMM. Finally, the SROs propose to modify the terms under which DMMs would be permitted to provide market information to Floor brokers and others.

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<sup>4</sup> Securities Exchange Act Release Nos. 65735 (November 10, 2011), 76 FR 71405 (SR-NYSEAmex-2011-86) and 65736 (November 10, 2011), 76 FR 71399 (SR-NYSE-2011-56).

<sup>5</sup> See Securities Exchange Act Release No. 66036, 76 FR 82011 (December 29, 2011).

A. Trading Floor Functions

The SROs propose to codify certain Trading Floor functions formerly performed by specialists that are to be performed by DMMs, and were described in each SRO's respective Floor Official Manual.<sup>6</sup>

The proposed rules would specify four categories of Trading Floor functions that DMMs could perform: (1) maintaining order among Floor brokers manually trading at the DMM's assigned panel;<sup>7</sup> (2) bringing Floor brokers together to facilitate trading;<sup>8</sup> (3) assisting Floor brokers with respect to their orders by providing information regarding the status of a Floor broker's orders, helping to resolve errors or questioned trades, adjusting errors, and cancelling or inputting Floor broker agency interest on behalf of a Floor broker;<sup>9</sup> and (4) researching the status of orders or questioned trades.<sup>10</sup>

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<sup>6</sup> See 2004 Floor Official Manual, Market Surveillance June 2004 Edition, Chapter Two, Section I.

<sup>7</sup> See id. at Section I.A. at 7 (“specialist helps ensure that such markets are fair, orderly, operationally efficient and competitive with all other markets in those securities”).

<sup>8</sup> See id. at Section I.B.3. at 10-11 (“[i]n opening and reopening trading in a listed security, a specialist should . . . [s]erve as the market coordinator for the securities in which the specialist is registered by exercising leadership and managing trading crowd activity and promptly identifying unusual market conditions that may affect orderly trading in those securities, seeking the advice and assistance of Floor Officials when appropriate” and “[a]ct as a catalyst in the markets for the securities in which the specialist is registered, making all reasonable efforts to bring buyers and sellers together to facilitate the public pricing of orders, without acting as principal unless reasonably necessary”).

<sup>9</sup> See id. at Section I.B.4. at 11 (“In view of the specialist's central position in the Exchange's continuous two-way agency auction market, a specialist should proceed as follows . . . [e]qually and impartially provide accurate and timely market information to all inquiring members in a professional and courteous manner.”).

<sup>10</sup> See id. at Section I.B.5. at 12 (A specialist should “[p]romptly provide information when necessary to research the status of an order or a questioned trade and cooperate with other members in resolving and adjusting errors.”).

B. DMM Access to Additional Order Information

Each SRO proposes to make systems available to a DMM at the post that display the following types of information about securities in which the DMM is registered: (A) aggregated information about buying and selling interest;<sup>11</sup> (B) disaggregated information about the price and size of any individual order or Floor broker agency interest file (also known as “e-Quotes”), and the entering and clearing firm information for such orders, except that Exchange systems would not make available to DMMs information about any order or e-Quote, or portion thereof, that a market participant has elected not to display to a DMM; and (C) post-trade information.<sup>12</sup> The proposals would make available to DMMs disaggregated information about the following interest in securities in which the DMM is registered: (a) the price and size of all displayable interest submitted by off-Floor participants; and (b) all e-Quotes, including reserve e-Quotes, that the Floor broker has not elected to exclude from availability to the DMM.<sup>13</sup>

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<sup>11</sup> Exchange systems currently make available to DMMs aggregate information about the following interest in securities in which the DMM is registered: (a) all displayable interest submitted by off-Floor participants; (b) all Minimum Display Reserve orders, including the reserve portion; (c) all displayable Floor broker agency interest files (“e-Quotes”); (d) all Minimum Display Reserve e-Quotes, including the reserve portion; and (e) the reserve quantity of Non-Display Reserve e-Quotes, unless the Floor broker elects to exclude that reserve quantity from availability to the DMM.

<sup>12</sup> For the latter two categories, the DMM also would have access to entering and clearing firm information for each order and, as applicable, the badge number of the Floor broker representing the order. According to the SROs, the systems would not contain any information about the ultimate customer (*i.e.*, the name of the member or member organization’s customer) in a transaction.

<sup>13</sup> The SROs previously permitted DMMs to have access to Exchange systems that contained the disaggregated order information described above. The SROs stopped making such information available to DMMs on January 19, 2011. See NYSE and NYSE Amex Information Memo 11-03.

C. Conforming Amendments and Floor Broker e-Quote Information

The SROs also propose to make conforming amendments to their rules to reflect the additional order information that would be available to DMMs through Exchange systems, and to specify what information about e-Quotes is available to the DMM. Specifically, the SROs propose to revise NYSE Rule 70 and NYSE Amex Rule 70 governing Floor broker e-Quotes to reflect that disaggregated order information would be available to the DMM except as elected otherwise. The SROs would allow a Floor broker to enter e-Quotes with reserve interest (“Reserve e-Quote”) with or without a displayable portion.

A Reserve e-Quote with a displayable portion would participate in manual and automatic executions. Order information at each price point, including the reserve portion, would be included in the aggregate interest available to the DMM. Order information at each price point would be available to the DMM on a disaggregated basis as well. If the Floor broker chooses to exclude the Reserve e-Quote with a displayable portion from the DMM, then the DMM would have access to the entire portion on an aggregated basis but would not have access to any of that interest on a disaggregated basis.

A Floor broker Reserve e-Quote with an undisplayable portion would also participate in manual and automatic executions. Like the Reserve e-Quote with a displayable portion, order information at each price point would be included in the aggregate interest available to DMM. Again, like the Reserve e-Quote with a displayable portion, order information at each price point would be available to DMM on a disaggregated basis as well. If the Floor broker chooses to exclude the Reserve e-Quote with an undisplayable portion from the DMM, however, then the DMM would not have access to such interest on either an aggregated basis or a disaggregated basis. Such interest would not participate in manual executions.

In addition, the SROs propose to delete rules which currently prohibit DMMs from using the Display Book system to access information about Floor broker agency interest excluded from the aggregated agency interest and Minimum Display Reserve Order information, other than for the purpose of effecting transactions that are reasonably imminent where such Floor broker agency and Minimum Display Reserve Order interest information is necessary to effect such transaction.<sup>14</sup>

D. Ability of DMMs to Provide Market Information on the Trading Floor

The SROs also propose to modify the manner under which DMMs would be permitted to provide market information to Floor brokers and visitors on the Trading Floor. Specifically, the proposed rules would permit a DMM to provide the market information to which he or she has access to a: (1) Floor broker in response to an inquiry in the normal course of business; or (2) visitor to the Trading Floor for the purpose of demonstrating methods of trading. As such, Floor brokers would be able to access disaggregated order information that market participants have not otherwise elected to be hidden from the DMM. A Floor broker would not be able to submit such an inquiry for market information by electronic means, and the DMM's response containing market information could not be through electronic means.

Because the proposed rule expands on and incorporates the current SRO rules regarding disclosure of order information by DMMs, the SROs are proposing to delete these rules.<sup>15</sup> The current rules provide that a DMM may disclose market information for three purposes. First, a DMM may disclose market information for the purpose of demonstrating the methods of trading to visitors to the Trading Floor. This aspect of the current rule is replicated in the proposed rules.

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<sup>14</sup> See proposed deletions to NYSE Rule 104(a)(6) and NYSE Amex Rule 104(a)(b).

<sup>15</sup> The SROs are also proposing conforming amendments to correct cross-references to the former rule.

Second, a DMM may disclose market information to other market centers in order to facilitate the operation of the Intermarket Trading System (“ITS”). According to the SROs, this text is obsolete as the ITS Plan has been eliminated and therefore the SROs are proposing to delete it. Third, a DMM may, while acting in a market making capacity, provide information about buying or selling interest in the market, including (a) aggregated buying or selling interest contained in Floor broker agency interest files other than interest the broker has chosen to exclude from the aggregated buying and selling interest, (b) aggregated interest of Minimum Display Reserve Orders and (c) the interest included in DMM interest files, excluding Capital Commitment Schedule (“CCS”) interest as described in Rule 1000(c), in response to an inquiry from a member conducting a market probe in the normal course of business.

The proposed rules would permit DMMs to provide Floor brokers not only with the same aggregated order information that DMMs currently are permitted to provide under current rules, but also with the disaggregated and post-trade order information described above.<sup>16</sup> In the SROs’ view, broadening the scope of information that DMMs can provide Floor brokers would assist DMMs with carrying out their historical function of bringing Floor brokers together to facilitate trading.<sup>17</sup> The SROs believe, among other things, that providing Floor brokers access to disaggregated order information would increase their ability to source liquidity and provide price discovery for block transactions.

The proposed rules would permit a DMM to provide market information to a Floor broker in response to a specific request by the Floor broker to the DMM at the post, rather than

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<sup>16</sup> Because DMMs on the Trading Floor do not have access to CCS interest information, the proposed rule does not specify that DMMs would not be disseminating such information.

<sup>17</sup> According to the SROs, prior to adoption of the Hybrid Market, Exchange specialists historically had been permitted to provide disaggregated order information to Floor brokers.

specifying that the information must be provided “in response to an inquiry from a member conducting a market probe in the normal course of business,” as currently provided in the SRO rules. According to the SROs, the term “market probe” no longer accurately reflects the manner in which DMMs and Floor brokers interact on the Trading Floor. Rather, the SROs stated that the Floor broker’s normal course of business, as an agent for customers, includes both seeking market probes into the depth of the market as well as seeking out willing contra-side buyers and sellers in a particular security. Under the proposed rule change, Floor brokers would not have access to Exchange systems that provide disaggregated order information, and they would only be able to access such market information through a direct interaction with a DMM at the post.

III. Proceedings to Determine Whether to Disapprove SR-NYSE-2011-56 and SR-NYSEAmex-2011-86 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act to determine whether the SRO Proposals should be disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the SRO Proposals that are 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 below, the Commission seeks and encourages interested persons to provide additional comment on the SRO Proposals.

Pursuant to Section 19(b)(2)(B), the Commission is providing notice of the grounds for disapproval under consideration. In particular, Section 6(b)(5) of the Act<sup>18</sup> 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

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<sup>18</sup> 15 U.S.C. 78f(b)(5).



investors and the public interest. In addition, Section 6(b)(5) prohibits the rules of an exchange from being designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

As the Commission has previously recognized, the participation of market makers in exchange markets may benefit public customers by promoting more liquid and efficient trading, and an exchange may legitimately confer benefits on market participants willing to accept substantial responsibilities to contribute to market quality.<sup>19</sup> While the rules of an exchange may confer special or unique benefits upon certain types of participants, however, such rules still must ensure, among other things, that investors and the public interest are protected.<sup>20</sup> Accordingly, the Commission carefully reviews trading rule proposals that seek to offer special advantages to market makers and others. Although an exchange may reward such participants for the benefits they provide to the exchange's market, such rewards must not be disproportionate to the services provided.<sup>21</sup>

In their proposals, the SROs take the position that providing DMMs with disaggregated order information would assist them in carrying out their trading floor functions, such as maintaining order among Floor brokers manually trading at the DMM's assigned panel, bringing Floor brokers together to facilitate trading, assisting Floor brokers with respect to their orders, and researching the status of orders or questioned trades. The SROs also believe that providing

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<sup>19</sup> See, e.g., Securities Exchange Act Release No. 58845 (October 24, 2008), 73 FR 64379 (October 29, 2008) (SR-NYSE-2008-46) ("New Market Model Order"), at 64388. See also Securities Exchange Act Release No. 58092 (July 3, 2008), 73 FR 40144 (July 11, 2008) at 40148.

<sup>20</sup> See New Market Model Order at 64388. See also 15 U.S.C. 78f(b)(5).

<sup>21</sup> See New Market Model Order at 64388. At the time NYSE adopted its New Market Model, the Commission believed that the rules reflected "an appropriate balance of DMM obligations against the benefits provided to DMMs under [the] proposal." Id.

this information to Floor brokers would serve a valuable function by increasing the ability of Floor brokers to source liquidity and provide price discovery for block transactions.

While the SRO proposals may improve the ability of DMMs and Floor brokers to trade on the SROs, they also would provide DMMs and Floor brokers access to potentially valuable information about individual orders on the SROs that is not available to other exchange members or market participants. This information would include the price and size of individual orders on the SROs, as well as the entering and clearing firm for such orders. It also would include information about trading interest that is not available to other exchange members or market participants even in aggregated form, such as Floor broker Reserve e-Quotes (unless there has been an affirmative election to withhold this information). As noted above, while the Commission has recognized that exchanges may legitimately confer special benefits on market participants willing to accept substantial responsibilities to contribute to market quality, such benefits must not be disproportionate to the services provided. In this case, the SROs have not proposed to require of DMMs or Floor brokers any additional obligations to the market that might correspond to the proposed informational benefits.<sup>22</sup> Nor have the SROs clearly explained how the proposals might materially improve the quality of the SROs' markets, particularly given the increasing amount of automated transactions on the SROs and the reduced role of the Exchange floors. As a result, the Commission is concerned that that the SROs' proposals, among other things, may unfairly discriminate in favor of DMMs and Floor brokers, may not be designed to protect the broad group of investors that trade on the SROs, and otherwise may be inequitable.

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<sup>22</sup> The Commission further notes that, while DMMs have certain special obligations to the SROs, including those relating to the maintenance of a fair and orderly market, Floor brokers do not have similar obligations.

The Commission therefore believes that questions remain as to whether the SRO Proposals are consistent with the requirements of Sections 6(b)(5) of the Act, including whether they would promote just and equitable principles of trade, perfect the mechanism of a free and open market and the national market system, protect investors and the public interest, and not permit unfair discrimination.

#### VI. 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 others they may have with the SRO Proposals. In particular, the Commission invites the written views of interested persons concerning whether the SRO Proposals are inconsistent with Section 6(b)(5) or any other provision 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 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.<sup>23</sup>

Interested persons are invited to submit written data, views and arguments regarding whether the SRO Proposals should be 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].

Comments may be submitted by any of the following methods:

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<sup>23</sup> 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, 94<sup>th</sup> Cong., 1<sup>st</sup> Sess. 30 (1975).

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 Numbers SR-NYSE-2011-56 and SR-NYSEAmex-2011-86 on the subject line.

Paper comments:

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

All submissions should refer to File Numbers SR-NYSE-2011-56 and SR-NYSEAmex-2011-86.

These file numbers 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 SRO Proposals that are filed with the Commission, and all written communications relating to the SRO Proposals 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 such filings also will be available for inspection and copying at the principal office of the Exchanges. 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 Numbers SR-NYSE-2011-56 and SR-NYSEAmex-2011-86 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 date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>24</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>24</sup> 17 CFR 200.30-3(a)(57).