

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-76395; File No. SR-NYSEARCA-2015-106)

November 9, 2015

Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt a Principles-Based Approach to Prohibit the Misuse of Material Nonpublic Information by Lead Market Makers (“LMMs”) by Deleting Rule 6.83

Pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (the “Act”)<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> notice is hereby given that, on October 28, 2015, NYSE Arca, Inc. (the “Exchange” or “NYSE Arca”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. 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 to adopt a principles-based approach to prohibit the misuse of material nonpublic information by Lead Market Makers (“LMMs”) by deleting Rule 6.83. The text of 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.

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 self-regulatory organization 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

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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.

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 adopt a principles-based approach to prohibit the misuse of material nonpublic information by LMMs by deleting Rule 6.83.

The Exchange believes that Rule 6.83 is no longer necessary because all OTP Holders and OTP Firms (collectively, “OTPs”),<sup>4</sup> including LMMs, are subject to the Exchange’s general principles-based requirements governing the protection against the misuse of material, non-public information, pursuant to Exchange Rule 11.3 (Prevention of the Misuse of Material, Nonpublic Information). This rule obviates the need for separately-prescribed requirements for a subset of market participants on the Exchange.

Background

The Exchange has two classes of registered market makers. Pursuant to Rule 6.32(a), a Market Maker is an individual who is registered with the Exchange for the purpose of making transactions as a dealer-specialist on the Floor of the Exchange or for the purpose of submitting quotes electronically and making transactions as a dealer-specialist through the NYSE Arca OX electronic trading system. As the rule further provides, a Market Maker registered on the Exchange will be either a Market Maker or a Lead Market Maker.<sup>5</sup>

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<sup>4</sup> An “OTP” is an Options Trading Permit issued by the Exchange for effecting approved securities transactions on the Exchange’s Trading Facilities; OTP Holders and OTP Firms are natural persons or business entities, respectively, that have one or more OTP. See Rule 1.1(p)-(r).

<sup>5</sup> Unless specified, or unless the context requires otherwise, the term Market Maker refers to both Market Makers and Lead Market Maker. See Rule 6.32(a).

Rule 6.82(c) specifies the obligations of LMMs, which, in addition to the Market Maker obligations of Rules 6.37 and 6.37A, must also honor guaranteed markets. The quoting obligations of all Market Makers, including LMMs, are set forth in Rule 6.37B. That rule sets forth the main difference between Market Makers and LMMs, namely that LMMs have a heightened quoting obligation as compared to Market Makers.<sup>6</sup> In addition to a heightened quoting obligation, pursuant to Rule 6.76A (Order Execution – OX), LMMs quoting at the NBBO are eligible to receive a guaranteed participation allocation in the execution of incoming bids and offers.<sup>7</sup>

Importantly, all Market Makers, including LMMs, have access to the same information in the Consolidated Book that is available to all other market participants. Moreover, none of the Exchange’s Market Makers, including LMMs, have agency obligations to orders in the Exchange’s Consolidated Book. As such, the key distinctions between Market Makers and LMMs are the quoting requirements set forth in Rule 6.37B and allocation guarantee for LMMs set forth in Rule 6.76A.

Notwithstanding that all Market Makers have access to the same Exchange trading information as all other market participants on the Exchange, the Exchange has specific rules governing how LMMs may operate. Rule 6.83 prohibits OTPs affiliated with an LMM from purchasing or selling any option to which the LMM is appointed, except to reduce or liquidate positions after appropriate identification and Trading Official approval of the transaction. The rule further provides an exemption from the prohibition for affiliated firms that implement

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<sup>6</sup> Compare Rule 6.37B(b) (An LMM “must provide continuous two-sided quotations throughout the trading day in its appointed issues for 90% of the time the Exchange is open for trading in each issue”[sic] with 6.37B(c) (“A Market Maker must provide continuous two-sided quotations throughout the trading day in its appointed issues for 60% of the time the Exchange is open for trading in each issue”).

<sup>7</sup> See Rule 6.76A(a)(1)(A).

specified Exchange-approved procedures to restrict the flow of material, non-public information. Rules 6.83(e) – (j) outline the “Exemption Guidelines” with which an affiliated firm must comply to obtain an exemption from the restriction in Rule 6.83. These specified “Exemption Guidelines” are meant to ensure that an LMM will not have access to material, non-public information possessed by its affiliated OTP(s), and that a firm will not misuse its affiliated LMM’s material, non-public information.

#### Proposed Rule Change

The Exchange believes that the guidelines in Rule 6.83 for LMMs are no longer necessary and proposes to delete the Rule in its entirety. The Exchange believes that Rule 11.3, governing the misuse of material, non-public information, provides for an appropriate, principles-based approach to prevent the market abuses Rule 6.83 was designed to address. Specifically, Rule 11.3 requires every OTP to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, non-public information by such OTP or associated persons. For purposes of this requirement, 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.<sup>8</sup>

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<sup>8</sup> See Commentary .01 to Rule 11.3.

Because LMMs are already subject to the requirements of Rule 11.3, the Exchange does not believe that it is necessary to separately require specific limitations on dealings between LMMs and their affiliates. Deleting Rule 6.83 would provide LMMs with the flexibility to adapt their policies and procedures as appropriate to reflect changes to their business model, business activities, or the securities market in a manner similar to how Market Makers on the Exchange currently operate and consistent with Rule 11.3.

As noted above, LMMs are distinguished under Exchange rules from other types of Market Makers in that LMMs have heightened obligations and allocation guarantees. However, none of these heightened obligations provides different or greater access to nonpublic information than any other market participant on the Exchange.<sup>9</sup> Specifically, LMMs on the Exchange do not have access to trading information provided by the Exchange, either at, or prior to, the point of execution, that is not made available to all other market participants on the Exchange in a similar manner. Further, as noted above, LMMs on the Exchange do not have any agency responsibilities for orders in the Consolidated Book. Accordingly, because LMMs do not have any trading advantages at the Exchange due to their market role, the Exchange believes that they should be subject to the same rules regarding the protection against the misuse of material non-public information, which in this case, is existing Rule 11.3.<sup>10</sup>

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<sup>9</sup> See Rules 6.37B and 6.76A.

<sup>10</sup> The Exchange notes that by deleting Rule 6.83, the Exchange would no longer require specific information barriers for LMMs or require pre-approval of any information barriers that an LMM would erect for purposes of protecting against the misuse of material non-public information. However, as is the case today with Market Makers, information barriers of new entrants, including new LMMs, would be subject to review as part of a new firm application. Moreover, the policies and procedures of LMMs, including those relating to information barriers, would be subject to review by FINRA, on behalf of the Exchange, pursuant to a Regulatory Services Agreement.

The Exchange notes that even with this proposed rule change, pursuant to Rule 11.3, an LMM would still be obligated to ensure that its policies and procedures reflect the current 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, including being reasonably designed to protect against the misuse of material, non-public information. While information barriers would not specifically be required under the proposal, Rule 11.3 already requires that an OTP consider its business model or business activities in structuring its policies and procedures, which 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.

The Exchange 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 an LMM could share with such LMM. In that regard, the proposed rule change will not permit the affiliates of LMMs to have access to any non-public order or quote information of the LMM, including hidden or undisplayed size or price information of such orders or quotes. Affiliates of LMMs would only have access to orders and quotes that are publicly available to all market participants. OTPs do not expect to receive any additional order or quote information as a result of this proposed rule change.

Further, the Exchange does not believe that there will be any material change to Market Maker information barriers as a result of removal of the Exchange's pre-approval requirements. In fact, the Exchange anticipates that eliminating the pre-approval requirement should facilitate implementation of changes to Market Maker 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 LMMs do not have agency responsibilities to orders in the Consolidated Book, or time and place information advantages because of their market role. However, as is the case today with Market Makers, information barriers of new entrants would be subject to review as part of a new firm application. Moreover, the policies and procedures of market makers, including those relating to information barriers, would be subject to review by FINRA, on behalf of the Exchange, pursuant to a Regulatory Services Agreement.

The Exchange further notes that under Rule 11.3, an OTP would be able to structure its firm to provide for its options LMMs, or Market Makers, as applicable, to be structured with its equities and customer-facing businesses, provided that any such structuring would be done in a manner reasonably designed to protect against the misuse of material, non-public information. For example, pursuant to Rule 11.3, a Market Maker on the Exchange could be in the same independent trading unit, as defined in Rule 200(f) of Regulation SHO,<sup>11</sup> as an equities market maker and other trading desks within the firm, including options trading desks, so that the firm could share post-trade information to better manage its risk across related securities. The Exchange believes it is appropriate, and consistent with Rule 11.3 and Section 15(g) of the Act<sup>12</sup> for a firm to 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. The Exchange notes, however, that if so structured, a firm would need to have appropriate policies and procedures, including information barriers as applicable, to protect against the misuse of material non-public information, and specifically customer information, consistent with Rule 11.3.

The Exchange believes that the proposed reliance on the principles-based Rule 11.3

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<sup>11</sup> 17 CFR Part 242.200(f).

<sup>12</sup> 15 U.S.C. 78o(g).

would help ensure that an OTP that operates an LMM would be required to protect against the misuse of any material non-public information. As noted above, Rule 11.3 already requires that firms refrain from trading while in possession of material non-public information concerning imminent transactions in the security or related product. The Exchange believes that moving to a principles-based approach rather than prescribing how and when to wall off an LMM from the rest of the firm would provide OTPs operating LMMs with appropriate tools to better manage risk across a firm, including integrating options positions with other positions of the firm or, as applicable, by the respective independent trading unit. Specifically, the Exchange believes that it is appropriate for risk management purposes for an OTP operating an LMM to be able to consider both options LMMs' traded positions for purposes of calculating net positions consistent with Rule 200 of Regulation SHO, calculating intra-day net capital positions, and managing risk both generally as well as in compliance with Rule 15c3-5 under the Act (the "Market Access Rule").<sup>13</sup> The Exchange notes that any risk management operations would need to operate consistent with the requirement to protect against the misuse of material non-public information.

The Exchange further notes that if LMMs are integrated with other market making operations, they would be subject to existing rules that prohibit OTPs 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. As such, an OTP that integrates its LMM operations together with equity market making would need to protect customer information consistent with existing obligations to protect such information. The Exchange has rules prohibiting OTPs from disadvantaging their customers or other market participants by

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<sup>13</sup> 17 CFR Part 240.15c3-5.



improperly capitalizing on the OTP's access to or receipt of material, non-public information. For example, Rule 11.18 requires OTPs 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. Additionally, Rule 6.49 prevents an OTP or person associated with an OTP, 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 circumstances are met.<sup>14</sup>

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>15</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>16</sup> in particular, in that it is designed 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.

The Exchange believes that the proposed rule change would remove impediments to and perfect the mechanism of a free and open market by adopting a principles-based approach to permit an OTP operating an LMM to maintain and enforce policies and procedures to, among other things, prohibit the misuse of material non-public information and eliminating restrictions on how an OTP structures its LMM operations. The Exchange notes that the proposed rule change is based on an approved rule of the Exchange to which LMMs are already subject – Rule

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<sup>14</sup> See Rule 6.49(b).

<sup>15</sup> 15 U.S.C. § 78f(b).

<sup>16</sup> 15 U.S.C. § 78f(b)(5).

11.3 – and harmonizes the rules governing LMMs and Market Makers. Moreover, OTPs operating LMMs would continue to be subject to federal and Exchange requirements for protecting material non-public order information.<sup>17</sup> The Exchange believes that the proposed rule change would remove impediments to and perfect the mechanism of a free and open market because it would harmonize the Exchange’s approach to protecting against the misuse of material nonpublic information and no longer subject LMMs to additional requirements. The Exchange does not believe that the existing requirements applicable to LMMs are narrowly tailored to their respective roles because neither market participant has access to Exchange trading information in a manner different from any other market participant on the Exchange and they do not have agency responsibilities to the Consolidated Book.

The Exchange further believes the proposal is designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade because existing rules make clear to LMMs and OTPs the type of conduct that is prohibited by the Exchange. While the proposal eliminates requirements relating to the misuse of material non-public information, LMMs and OTPs would remain subject to existing Exchange rules requiring them to establish and maintain systems to supervise their activities, and to create, implement, and maintain written procedures that are reasonably designed to comply with applicable securities laws and Exchange rules, including the prohibition on the misuse of material, nonpublic information.

The Exchange notes that the proposed rule change would still require that OTPs operating LMMs maintain and enforce policies and procedures reasonably designed to ensure compliance with applicable federal securities laws and regulations and with Exchange rules.

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<sup>17</sup> See 15 U.S.C. 78o(g) and Rule 11.3.

Even though there would no longer be pre-approval of LMM information barriers, any LMM written policies and procedures would continue to be subject to oversight by the Exchange and therefore the elimination of prescribed restrictions should not reduce the effectiveness of the Exchange rules to protect against the misuse of material non-public information. Rather, OTPs will be able to utilize a flexible, principles-based approach to modify their policies and procedures as appropriate to reflect changes to their business model, business activities, or to the securities market itself. Moreover, while specified information barriers may no longer be required, an OTP's business model or business activities may dictate that an information barrier or functional separation be part of the appropriate set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Exchange rules. The Exchange therefore believes that the proposed rule change will maintain the existing protection of investors and the public interest that is currently applicable to LMMs, while at the same time removing impediments to and perfecting a free and open market by moving to a principles-based approach to protect against the misuse of material non-public information.

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

In accordance with Section 6(b)(8) of the Act,<sup>18</sup> the Exchange does not believe that the proposed rule change would impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. To the contrary, the Exchange believes that the proposal will enhance competition by allowing Market Makers to comply with applicable Exchange rules in a manner best suited to their business models, business activities, and the securities markets, thus reducing regulatory burdens while still ensuring compliance with

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<sup>18</sup> 15 U.S.C. 78f(b)(8).

applicable securities laws and regulations and Exchange rules. The Exchange believes that the proposal will foster a fair and orderly marketplace without being overly burdensome upon Market Makers.

Moreover, the Exchange believes that the proposed rule change would eliminate a burden on competition for OTPs which currently exists as a result of disparate rule treatment between the options and equities markets regarding how to protect against the misuse of material non-public information. For those OTPs that are also members of equity exchanges, their respective equity market maker operations are now subject to a principles-based approach to protecting against the misuse of material non-public information.<sup>19</sup> The Exchange believes it would remove a burden on competition to enable OTPs to similarly apply a principles-based approach to protecting against the misuse of material nonpublic information in the options space. To this end, the Exchange notes that Rule 11.3 still requires an OTP that operates as a Market Maker on the Exchange, including an LMM, to evaluate its business to assure that its policies and procedures are reasonably designed to protect against the misuse of material nonpublic information. However, with this proposed rule change, an OTP that trades equities and options could look at its firm more holistically to structure its operations in a manner that provides it

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<sup>19</sup> See Securities Exchange Act Release Nos. 60604 (Sept. 2, 2009), 76 FR 46272 (Sept. 8, 2009) (SR-NYSEArca-2009-78) (Order approving elimination of NYSE Arca rule that required market makers to establish and maintain specifically prescribed information barriers, including discussion of NYSE Arca and Nasdaq rules) (“Arca Approval Order”); 61574 (Feb. 23, 2010), 75 FR 9455 (Mar. 2, 2010) (SR-BATS-2010-003) (Order approving amendments to BATS Rule 5.5 to move to a principles-based approach to protecting against the misuse of material, non-public information, and noting that the proposed change is consistent with the approaches of NYSE Arca and Nasdaq) (“BATS Approval Order”); and 72534 (July 3, 2014), 79 FR 39440 (July 10, 2014), SR-NYSE-2014-12) (Order approving amendments to NYSE Rule 98 governing designated market makers to move to a principles-based approach to prohibit the misuse of material non-public information) (“NYSE Approval Order”).

with better tools to manage its risks across multiple security classes, while at the same time protecting against the misuse of material non-public information.

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 the Act<sup>20</sup> and Rule 19b-4(f)(6) thereunder.<sup>21</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)(iii) thereunder.

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>22</sup> of the Act to determine whether the proposed rule change should be approved or disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning

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<sup>20</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>21</sup> 17 CFR 240.19b-4(f)(6).

<sup>22</sup> 15 U.S.C. 78s(b)(2)(B).

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-NYSEARCA-2015-106 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NYSEARCA-2015-106. 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 20549-1090, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing will also be available for inspection and copying at the NYSE's principal office and on its Internet website at [www.nyse.com](http://www.nyse.com). 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-NYSEARCA-2015-106 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>23</sup>

Robert W. Errett  
Deputy Secretary

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<sup>23</sup> 17 CFR 200.30-3(a)(12).