

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-86151; File No. SR-NYSE-2019-34)

June 19, 2019

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change amend Exchange Rule 104 to Specify Designated Market Maker Requirements for Exchange Traded Products listed on the Exchange

Pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (“Act”)² and Rule 19b-4 thereunder,³ notice is hereby given that, on June 7, 2019, New York Stock Exchange LLC (“NYSE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III 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 amend Rule 104 to specify Designated Market Maker (“DMM”) requirements for Exchange Traded Products (“ETPs”) listed on the Exchange pursuant to Rules 5P and 8P. The proposed rule change is available on the Exchange’s website at 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

¹ 15 U.S.C.78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

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 Rule 104 (Dealings and Responsibilities of DMMs) to specify DMM requirements for ETPs listed on the Exchange pursuant to Rules 5P and 8P.

Background

Currently, the Exchange trades securities, including ETPs, on its Pillar trading platform on an unlisted trading privileges (“UTP”) basis, subject to Pillar Platform Rules 1P - 13P.⁴ In the next phase of Pillar, the Exchange proposes to transition trading of Exchange-listed securities to the Pillar trading platform, which means that DMMs would be trading on Pillar in their assigned securities.⁵ Once transitioned to Pillar, such securities will also be subject to the Pillar Platform Rules 1P - 13P.

Rules 5P (Securities Traded) and 8P (Trading of Certain Exchange Traded Products) provide for the listing of certain ETPs⁶ on the Exchange that (1) meet the applicable

⁴ “UTP Security” is defined as a security that is listed on a national securities exchange other than the Exchange and that trades on the Exchange pursuant to unlisted trading privileges. See Rule 1.1.

⁵ The Exchange has announced that, subject to rule approvals, the Exchange will begin transitioning Exchange-listed securities to Pillar on August 5, 2019, available here: https://www.nyse.com/publicdocs/nyse/markets/nyse/Revised_Pillar_Migration_Timeline.pdf. The Exchange will publish by separate Trader Update a complete symbol migration schedule.

⁶ Rule 1.1P(k) defines “Exchange Traded Product” as a security that meets the definition of “derivative securities product” in Rule 19b-4(e) under the Act.

requirements set forth in those rules, and (2) do not have any component NMS Stock⁷ that is listed on the Exchange or is based on, or represents an interest in, an underlying index or reference asset that includes an NMS Stock listed on the Exchange. ETPs listed under Rules 5P and 8P are “Tape A” listings and would be traded pursuant to the rules applicable to NYSE-listed securities.

The Exchange does not currently list any ETPs and anticipates that it would not do so until Exchange-listed securities transition to Pillar. Once an ETP is listed, it will be assigned to a DMM pursuant to Rule 103B. The DMMs’ role with respect to ETPs assigned to them will be subject to the same DMM rules governing all other listed securities, including Rules 36, 98, and 104. For example, DMMs will be responsible for facilitating the opening, reopening, and close of trading for assigned ETPs as required by Rule 104(a)(2) and (3). To facilitate DMM trading of Exchange-listed ETPs pursuant to Rules 5P and 8P, with this proposed change, the Exchange proposes to amend Rule 104 relating specified DMM requirements.

Current Rule 104

Rule 104 sets forth the obligations of Exchange DMMs. Under Rule 104(a), DMMs registered in one or more securities traded on the Exchange are required to engage in a course of dealings for their own account to assist in the maintenance of a fair and orderly market insofar as reasonably practicable. Rule 104(a) also enumerates the specific responsibilities and duties of a DMM, including: (1) maintenance of a continuous two-sided quote, which mandates that each DMM maintain a bid or an offer at the National Best Bid (“NBB”) and National Best Offer (“NBO”) (together, the “NBBO” or “inside”) at least 15% of the trading day for securities with a consolidated average daily volume of less than one million shares, and at least 10% for securities

⁷ NMS Stock is defined in Rule 600 of Regulation NMS, 17 CFR 242.600(b)(47).

with a consolidated average daily volume equal to or greater than one million shares,⁸ and (2) the facilitation of, among other things, openings, re-openings, and the close of trading for the DMM's assigned securities, all of which may include supplying liquidity as needed.⁹

Rule 104(f) imposes an affirmative obligation on DMMs to maintain, insofar as reasonably practicable, a fair and orderly market on the Exchange in assigned securities, including maintaining price continuity with reasonable depth and trading for the DMM's own account when lack of price continuity, lack of depth, or disparity between supply and demand exists or is reasonably to be anticipated. The Exchange supplies DMMs with suggested Depth Guidelines for each security in which a DMM is registered, and DMMs are expected to quote and trade with reference to the Depth Guidelines.¹⁰

Rule 104(g) provides that transactions on the Exchange by a DMM for the DMM's account must be effected in a reasonable and orderly manner in relation to the condition of the general market and the market in the particular stock. Rule 104(g) also describes certain transactions on the Exchange by a DMM for the DMM's account must be effected in a reasonable and orderly manner in relation to the condition of the general market and the market in the particular stock. In addition, if a DMM unit engages in an "Aggressing Transaction," i.e., a transaction that (i) is a purchase (sale) that reaches across the market to trade as the contra-side to the Exchange published offer (bid); and (ii) is priced above (below) the last-differently priced trade on the Exchange and above (below) the last differently-priced published offer (bid) on the

⁸ See Rule 104(a)(1)(A).

⁹ See Rule 104(a)(2)-(3). Rule 104(e) further provides that DMM units must provide contra-side liquidity as needed for the execution of odd-lot quantities eligible to be executed as part of the opening, reopening, and closing transactions but that remain unpaired after the DMM has paired all other eligible round lot sized interest.

¹⁰ See Rule 104(f)(3).

Exchange, such DMM is subject to specified requirements to re-enter on the opposite side of the Aggressing Transaction. Rule 104(g) also prohibits DMM Aggressing Transactions in the last ten minutes of trading if the transaction that create a new high/low price for the security on the Exchange for the day at the time of the DMM's transaction, subject to certain exceptions.

Proposed Rule Change

To reflect the differences in how ETPs trade and the unique role of exchange market makers in the trading of ETPs, in order to facilitate DMM trading of Exchange-listed ETPs pursuant to Rules 5P and 8P, the Exchange proposes certain amendments to Rule 104.

Unlike operating company securities listed on the Exchange, the value of ETPs are derived from the underlying assets owned. The end-of-day net asset value ("NAV") of an ETP is a daily calculation based off the most recent closing prices of the underlying assets and an accounting of the ETP's total cash position at the time of calculation. The NAV generally is calculated by taking the sum of fund assets, including any securities and cash, subtracting liabilities, and dividing by the number of outstanding shares. Additionally, ETPs are generally subject to a creation and redemption mechanism to ensure that the ETP's price does not fluctuate too far away from NAV, which mechanisms mitigate the potential for exchange trading to impact the price of an ETP.

Moreover, each business day, ETPs make publicly available a creation and redemption "basket" which may, for example, be in the form of a portfolio composition file (i.e., a specific list of names and quantities of securities or other assets designed to track the performance of the portfolio as a whole). ETP shares are created when an Authorized Participant, typically a market maker or other large institutional investor, deposits the daily creation basket or cash with the

issuer. In return for the creation basket or cash (or both), a “creation unit” is issued to the Authorized Participant that consists of a specified number of ETF shares.¹¹

The principal, and perhaps most important, feature of ETPs is their reliance on an “arbitrage function” performed by market participants that influences the supply and demand of shares and, thus, trading prices relative to NAV. As noted above, new ETP shares can be created and existing shares redeemed based on investor demand; thus, ETP supply is generally open-ended. As the Commission has acknowledged, the arbitrage function helps to keep an ETP’s price in line with the value of its underlying portfolio, i.e., it minimizes deviation from NAV.¹² Generally, the higher the liquidity and trading volume of an ETP, the more likely the ETP’s price will not deviate from the value of its underlying portfolio. Market makers registered in ETPs play a key role in this arbitrage function and DMMs, along with other market participants, would perform this role for ETPs listed on the Exchange. In short, the Exchange believes that the arbitrage mechanism is generally an effective and efficient means of ensuring that intraday pricing in ETPs closely tracks the value of the underlying portfolio or reference assets.

¹¹ For example, assume a given ETP is designed to track the performance of a specific index. An Authorized Participant will generally purchase certain of the constituent securities of that index, then deliver those shares to the issuer. In exchange, the issuer gives the Authorized Participant a block of equally valued ETP shares, on a one-for-one fair value basis. This process also works in reverse. A redemption is achieved when the Authorized Participant accumulates a sufficient number of shares to constitute a creation unit and then exchanges these shares with the issuer, thereby decreasing the supply of ETP shares in the marketplace.

¹² See Securities Exchange Act Release No. 75165, 80 FR 34729, 34733 (June 17, 2015) (S7-11-15) (arbitrage “generally helps to prevent the market price of ETP Securities from diverging significantly from the value of the ETP’s underlying or reference assets”). See also generally id., 80 FR at 34739 (“In the Commission’s experience, the deviation between the daily closing price of ETP Securities and their NAV, averaged across broad categories of ETP investment strategies and over time periods of several months, has been relatively small[.]” although it had been “somewhat higher” in the case of ETPs based on international indices.).

To reflect the role of market makers -- including DMMs -- in the trading of ETPs, the Exchange proposes to amend Rule 104 in several respects. First, the Exchange proposes to exclude ETPs from the definition of “Aggressing Transactions” in Rule 104(g) (Transactions by DMMs) and, by extension, from the prohibition on Aggressing Transactions in the last ten minutes prior to the scheduled close of trading that would result in a new high (low) price for a security on the Exchange for the day at the time of the DMM's transaction.

The Exchange believes that because of the unique characteristics of ETPs -- in particular, that ETPs trade at intra-day market prices rather than at NAV and the existence of arbitrage pricing mechanisms that are designed to help ensure that secondary market prices of ETP shares do not vary substantially from the NAV -- the DMM obligations set forth in Rule 104(g) not only are not necessary, but also could impede the ability of a DMM to effectively make markets in ETPs. For example, a market maker engaging in the arbitrage function may need to update the quote for an ETP to bring the price of the security in line with the underlying assets. If updating the quote consistent with that arbitrage function were to require the DMM to first to engage in an Aggressing Transaction (i.e., to trade with the existing BBO in order to post a new quote), the Exchange believes that the current re-entry obligations for Aggressing Transactions would defeat the purpose of the DMM engaging in such Aggressing Transaction to update the quote in the first place. More specifically, the re-entry obligation could be inconsistent with the new quote that the DMM is seeking to post as part of the arbitrage function. Indeed, the Exchange believes that without the proposed changes, DMMs assigned to ETPs would be at a competitive disadvantage vis-à-vis registered market makers in the same ETP on competing exchanges as well as other market participants on the NYSE and would be impeded in their ability to effectively make competitive markets in their assigned ETP securities.

For similar reasons, the Exchange does not believe that DMMs should be prohibited from engaging in Aggressing Transactions in the last ten minutes of trading. While DMMs will be responsible for facilitating the closing transaction pursuant to Rule 104(a)(3), given the nature of ETPs and how they are priced, the Exchange does not believe that the DMM will have any unique pricing power either leading into the close or when facilitating the close. In the ten minutes leading into the close, to perform its role as market maker, the DMM will continue to price such securities consistent with the arbitrage functions described above. And for the close, because an ETP should be priced at or very close the ETP's NAV, the Exchange believes that this pricing pressure will mitigate the potential for a DMM to influence the price of the ETP. In both cases, if a DMM's quotes become inconsistent with the value of the underlying basket, other market participants can profit by employing the arbitrage function and re-establishing consistency with the underlying basket similar to intraday trading of ETPs.

To maintain the balance between DMM benefits and obligations under Rule 104, the Exchange proposes to amend Rule 104 to require heightened DMM quoting obligations for Exchange-listed ETPs. As proposed, for listed ETPs, DMMs would be required to maintain a bid or offer at the NBB and NBO at least 25% of the trading day. Time at the inside for ETPs would be calculated in the same way as other securities in which DMM units are registered as the average of the percentage of time the DMM unit has a bid or offer at the inside. In other words, this would be a portfolio-based quoting requirement. Orders entered by the DMM in ETPs that are not displayed would not be included in the inside quote calculation as is also currently the case for other securities in which DMM units are registered. Reserve or other non-displayed orders entered by the DMM in their assigned ETP would not be included in the inside quote calculations.

To effectuate this change, Rule 104(a)(1)(A) would be amended as follows:

- The phrase “for securities in which the DMM unit is registered” would be added following the first sentence in Rule 104(a)(1)(A) and the comma following that initial sentence would be removed;
- New subsections (i), (ii) and (iii) would be created;
- The phrase “that are not ETPs” would be added following “at least 15% of the trading day for securities” in new subsection (i) and “in which the DMM unit is registered” would be deleted;
- The phrase “of the trading day”¹³ would added after “at least 10%” and “that are not ETPs” would be added after “for securities” in new subsection (ii). The phrase “in which the DMM unit is registered” would be deleted since it would appear in the first sentence of the amended rule;
- New subdivision (iii) providing that DMM units must maintain a bid or an offer at the inside “at least 25% of the trading day for ETPs” would be added; and
- The phrase “respective percentage” would replace “15% and 10%” in the next to last sentence of Rule 104(a)(1)(A) and “non-displayed” would replace “hidden” in the last sentence of the rule.

The Exchange also proposes non-substantive amendments to replace the terms “stock” and “stocks” in Rule 104(f)(2) (Function of DMMs) with the terms “security” and “securities,” respectively. The Exchange would also add a new subsection (5) to Rule 104(f) providing that, for those ETPs in which they are registered, DMM units will be responsible for the affirmative obligation of maintaining a fair and orderly market, including maintaining price continuity with

¹³ This is a non-substantive conforming change that would mirror the current rule text for the 15% requirement.

reasonable depth for their registered ETPs in accordance with Depth Guidelines published by the Exchange. To provide the Exchange time to collect trading data adequate to calculate appropriate Depth Guidelines for listed ETPs, the Exchange proposes that these provisions would not be operative until 18 weeks after the approval of the proposed rule change by the Commission.¹⁴

2. Statutory Basis

The Exchange believes that the proposal is consistent with Section 6(b) of the Act,¹⁵ in general, and furthers the objectives of Sections 6(b)(5) of the Act,¹⁶ in particular, because 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 regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to, and perfect the mechanisms of, a free and open market and a national market system and, in general, to protect investors and the public interest and because it is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the Exchange believes that proposed requirements for DMM trading of ETPs would remove impediments to and perfect the mechanism of a free and open market and a

¹⁴ See, e.g., Securities Exchange Act Release Nos. 62479 (July 9, 2010), 75 FR 41264, 41265 (July 15, 2010) (SR-NYSEAmex-2010-31) (providing for a delayed implementation of Depth Guidelines to enable the collection of trading data adequate to calculate the guidelines in connection with the Floor-based DMM trading of Nasdaq securities on a UTP basis). Such an approach is necessary so that appropriate Depth Guidelines may be calculated based on actual trading data on the Exchange. Accordingly, following implementation and roll-out of the pilot program, the Exchange proposes to collect 60 trading days of trade data before implementing Depth Guidelines for trading ETPs securities on the Exchange within 30 calendar days of the collection of the trade data. See generally *id.*, 75 FR at 41267 & n. 19.

¹⁵ 15 U.S.C. 78f(b).

¹⁶ 15 U.S.C. 78f(b)(5).

national market system by facilitating market making by DMMs in listed ETPs and maintaining the Exchange's current structure to trade listed securities. The Exchange believes that the proposed exclusion of listed ETPs from the requirements of Rule 104(g) would not be inconsistent with the public interest and the protection of investors because the unique characteristics of ETPs, including that ETPs trade at intra-day market prices rather than end-of-day NAV and are constrained by arbitrage pricing mechanisms that are designed to ensure that secondary market prices of ETP shares do not vary substantially from the NAV, render those obligations unnecessary or potentially even harmful. As discussed above, the Exchange also believes the DMM obligations set forth in Rule 104(g) could impede the ability of a DMM to effectively make markets in ETPs. For similar reasons, excluding listed ETPs from the prohibition on Aggressing Transactions in the last ten minutes of trading would not be inconsistent with the public interest and the protection of investors because, given the nature of ETPs and how they are priced, DMMs will not have any unique pricing power either leading into the close or when facilitating the close and these restrictions could end up impeding the alignment of ETP price with the underlying basket. Rather, in the ten minutes leading into the close, DMM will continue to price such securities consistent with the arbitrage functions described above and, because an ETP should be priced at NAV, the Exchange believes that this pricing pressure will reduce the potential for a DMM to potentially manipulate the price of ETPs going into the close.

The Exchange believes that the proposed heightened quoting obligations for DMMs in listed ETPs requiring maintenance of a bid or offer at the inside of at least 25% of the trading day would maintain the balance of benefits and obligations under Rule 104 because exclusion of listed ETPs from the requirements of Rule 104(g) would be offset by the heightened DMM

quoting obligations for listed ETPs. DMMs would also be required to facilitate the opening, reopening, and closing of listed ETPs assigned to them, as required by Rule 104(a)(2) and (3), which is an obligation unique to the Exchange. As noted, listed ETPs would also be subject to the requirement that DMM transactions be effected in a reasonable and orderly manner in relation to the condition of the general market and the market in the particular stock. These safeguards are designed to ensure that DMM transactions in listed ETPs bear a reasonable relationship to overall market conditions and that DMMs cannot destabilize, inappropriately influence or manipulate a security going into the close. For the same reasons, the proposed prohibition would not alter or disrupt the balance between DMM benefits and obligations of being an Exchange DMM.

The proposed heightened quoting obligation for listed ETPs assigned to a DMM would also encourage additional stable displayed liquidity on the Exchange in listed securities, thereby promoting price discovery and transparency. The Exchange further believes that by establishing distinct requirements for DMMs, the proposal is also designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade.

The Exchange believes that the proposal would not be inconsistent with the public interest and the protection of investors. As noted, the proposal would subject DMMs to the Exchange's current structure for trading listed securities and the responsibilities and duties of DMMs set forth in Rule 104, including facilitating openings, reopenings, and closings and adding a heightened quoting obligation at the inside. In addition, the proposed rule would subject listed ETPs to the requirement that all DMM transactions be effected in a reasonable and orderly manner in relation to the condition of the general market and the market in the particular stock. Although the implementation of Depth Guidelines will be delayed, DMM units will still

have the obligation once ETPs are listed and begin trading to maintain a fair and orderly market. The Exchange believes that the delayed implementation of Depth Guidelines will allow it to develop guidelines that are appropriately tailored for how ETPs will trade on the Exchange, which should improve the DMM units' ability to maintain a fair and orderly market and also the broader market for those securities here on the Exchange and on other markets.¹⁷

For the foregoing reasons, the Exchange believes that the proposal is consistent with the Act.

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

In accordance with Section 6(b)(8) of the Act,¹⁸ the Exchange believes that the proposed rule change would not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange believes that the proposed change would promote competition by facilitating the listing and trading of ETPs on the Exchange. The Exchange believes that without this proposed change, DMMs assigned to ETPs would be at a competitive disadvantage vis-à-vis registered market makers in the same ETP on competing exchanges or other market participants on the NYSE because if they were required to comply with requirements relating to Aggressing Transactions in Rule 104(g), they would be impeded in their ability to effectively make markets in their assigned ETP securities. The Exchange believes that the proposed heightened DMM quoting obligations in listed ETPs would promote competition by promoting the display of liquidity on an exchange, which would benefit all market participants. These proposed rule changes would facilitate the trading of Exchange-listed ETPs by DMMs on Pillar, which would enable the Exchange to further compete with unaffiliated exchange competitors that also trade ETPs.

¹⁷ See note 13, supra.

¹⁸ 15 U.S.C. 78f(b)(8).

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

Within 45 days of the date of publication of this notice in the Federal Register or up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

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. Please include File Number SR-NYSE-2019-34 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-2019-34. 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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSE-2019-34 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.¹⁹

Vanessa A. Countryman
Acting Secretary

¹⁹ 17 CFR 200.30-3(a)(12).