

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁶

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Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-72534; File No. SR-NYSE-2014-12]

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving Proposed Rule Change Amending Rule 98 To Adopt a Principles-based Approach To Prohibit the Misuse of Material Nonpublic Information and Make Conforming Changes to Other Exchange Rules

July 3, 2014.

On March 18, 2014, New York Stock Exchange LLC (“NYSE” or the “Exchange”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) ¹ and Rule 19b-4 thereunder,² filed with the Securities and Exchange Commission (the “Commission”) a proposed rule change to amend Rule 98. The proposed rule change was published for public comment in the *Federal Register* on April 7, 2014.³ On May 21, 2014, the Commission designated a longer period for Commission action on the proposed rule change.⁴ The Commission received one comment on the proposal.⁵ This order approves the proposed rule change.

I. Background and Introduction

The Exchange adopted Rule 98 in 1986, when NYSE specialist firms, which had been independent member-owned entities, increasingly became affiliates of larger member organizations. Because of the specialists’ position in the market, Rule 98 required an organizational separation between a specialist and its affiliates. The purpose of that separation was to eliminate or control conflicts of interest between the business activities of affiliates of the specialist and the specialist’s responsibilities to the

market and to any customer orders the specialist represented as agent.⁶

In 2008, the NYSE amended Rule 98 to adopt a more flexible, principles-based approach that among other things: (1) Redefined the persons to whom the rule applied; (2) allowed DMM operations to be integrated into better-capitalized member organizations; (3) permitted a DMM unit to share non-trading-related services with its parent member organization or approved persons; and (4) provided flexibility to member organizations and their approved persons in conducting risk management of DMM operations.⁷ The principal effect of the 2008 Amendments was that affiliates of a DMM unit that were walled-off from the DMM unit were no longer prohibited from acting as an options market maker in a security in which the affiliated DMM was registered. However, the amended Rule 98 continued to prohibit the integrated unit from coordinating market making between its DMM and its options market maker.

The Exchange now proposes to further amend Rule 98 in order to provide DMM units with greater flexibility in structuring their operations and to move further toward a principles-based approach and away from prescribing particular structures for DMM units. Under this proposed rule change, certain information barriers would continue to be required (for example, between a DMM unit and an affiliated investment-banking desk), and other required protections, in addition to information barriers, would address the role of DMMs and the trading floor in the NYSE’s market. Proposed Rule 98 would, however, contain fewer prescriptions relating to the structure of DMM units, and it would instead—like similar rules relating to market-making firms on other exchanges⁸—impose a more general requirement that a member organization operating a DMM unit maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of the member organization’s business, (i) to prevent the misuse of material, non-public information by the member organization or persons associated with it and (ii) to ensure compliance with applicable federal laws and regulations and with Exchange rules.

The Exchange asserts that the instant proposal should provide member organizations operating DMM units with the means to better manage risk across a firm—for example, by integrating DMM unit positions and quoting information with other quotes and positions by other units within the firm. The Exchange posits that a member organization operating a DMM unit, in the context of risk management⁹ and consistent with protections against the misuse of material non-public information,¹⁰ should be able to consider the outstanding quotes of the DMM unit as well as traded positions for purposes of calculating net positions consistent with Rule 200 of Regulation SHO¹¹ and calculating intra-day net capital positions. Further, the Exchange asserts that a member organization should be able to integrate its DMM unit operations with its customer-facing operations because the instant proposal, in tandem with existing NYSE conduct rules,¹² FINRA’s ongoing surveillances for manipulative conduct, and FINRA’s program to examine member firms that act as DMMs and to review and approve their policies and procedures for complying with Rule 98, should provide a regulatory framework that guards customer interests and protects against the misuse of material non-public information, while increasing the operational flexibility of member organizations.

II. Description of the Proposed Amendments to Rule 98

Proposed Rule 98(a)(1) provides that the rule shall apply to all member organizations seeking to operate a DMM unit at the Exchange and to any approved person that may provide services to a DMM unit.

⁹ See, e.g., 17 CFR part 240.15c3-5 (Risk Management Controls for Brokers or Dealers with Market Access).

¹⁰ See, e.g., 15 U.S.C. 78o(g). Section 15(g) of the Act requires every registered broker or dealer to “establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker’s or dealer’s business, to prevent the misuse . . . of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer.”

¹¹ 17 CFR 242.200. Under Regulation SHO, determination of a seller’s net position is based on the seller’s positions in the security in all proprietary accounts. See Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48010 n.22 (Aug. 6, 2004); see also Exchange Act Release No. 48709 (Oct. 29, 2003), 68 FR 62972, 62991 and 62994 (Nov. 6, 2003); Letter from Richard R. Lindsey, Director, Division of Market Regulation, to Roger D. Blanc, Wilkie Farr & Gallagher, SEC No-Action Letter, 1998 SEC No-Act. LEXIS 1038, p. 5 (Nov. 23, 1998); Exchange Act Release No. 30772 (June 3, 1992), 57 FR 24415, 24419 n.47 (June 9, 1992); Exchange Act Release No. 27938 (Apr. 23, 1990), 55 FR 17949, 17950 (Apr. 30, 1990).

¹² See, e.g., NYSE Rule 5320 (“Manning Rule”).

²⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 71837 (Apr. 1, 2014), 75 FR 19146.

⁴ See Securities Exchange Act Release No. 72203, 79 FR 30667 (May 28, 2014).

⁵ See E-mail from Dr. Lee Jackson, Esq. (Apr. 15, 2014) (“Jackson Comment”). The Commission does not believe the Jackson Comment raises any material or substantive issues.

⁶ See Securities Exchange Act Release No. 23768 (Nov. 3, 1986), 51 FR 41183 (Nov. 13, 1986) (SR-NYSE-85-25).

⁷ See Securities Exchange Act Release No. 58328 (Aug. 7, 2008), 34 FR 58328 (Aug. 18, 2008) (SR-NYSE-2008-45) (“2008 Amendments”).

⁸ See, e.g., NYSEArca Equities Rule 6.3 and BATS Rule 5.5.

Proposed Rule 98(b) revises, deletes, and adds certain definitions to provide member organizations operating a DMM unit with the flexibility to integrate their DMM operations with other units of the firm. Currently, Rule 98 defines the terms “non-public order information” and “DMM confidential information” separately. Non-public order information captures any information relating to order flow at the Exchange—including verbal indications of interest made with an expectation of privacy, electronic order interest, e-quotes, reserve interest, and information about imbalances at the Exchange—that is not publicly-available on a real-time basis via an Exchange-provided datafeed, such as NYSE OpenBook,¹³ or otherwise publicly available. “DMM confidential information” refers to principal or proprietary trading activity of a DMM unit at the Exchange in the securities allocated to it pursuant to Rule 103B, including the unit’s positions in those securities, decisions relating to trading or quoting in those securities, and any algorithm or computer system that is responsible for such trading activity and that interfaces with Exchange systems.

The Exchange proposes to replace the term “non-public information” with “Floor-based non-public information.” As discussed in more detail below, the Exchange proposes to maintain restrictions in proposed Rule 98(c)(3) to address the Floor-based activities of DMM units, and it proposes to use the term “Floor-based non-public order information” to identify the information those provisions are intended to protect.¹⁴ The Exchange also proposes to delete the definition of “DMM confidential information,” arguing that proposed Rule 98(c)(2) would sufficiently protect against the misuse of material non-public information. Further the Exchange notes that, to the extent a DMM on the Floor may have access to Floor-based non-public order information, proposed Rule 98(c)(3) would continue to specify required protections against the misuse of such information by the member organization.

The Exchange proposes to amend the term “DMM unit” to mean a trading unit within a member organization that

is approved pursuant to Rule 103 to act as a DMM unit, and it proposes to eliminate the requirement that a DMM unit be an “aggregation unit,” which is currently defined to mean any trading or market-making department, division, or desk that meets the requirements of the definition of “independent trading unit” pursuant to Rule 200 of Regulation SHO.¹⁵ The Exchange proposes to decouple the Rule 98 definition from Regulation SHO, in part because the two rules have different regulatory purposes.¹⁶ Similarly, the Exchange proposed to delete the term “integrated proprietary aggregation unit” because this term contemplates a DMM unit being part of an aggregation unit that only engages in proprietary trading activity, which, under the proposal, would be an organizational structure that is permitted, but not required. The Exchange also proposes to delete the definitions for “DMM API,” “DMM account,” “customer-facing department,”¹⁷ and “non-trading related services.”¹⁸ The Exchange asserts that the terms “DMM API” and “DMM account” are obsolete as they were based on NYSE Rule 104 before it was amended in 2008.¹⁹

Proposed Rule 98(c) would govern the operation of a DMM unit. Proposed Rule 98(c)(1) provides that a member organization will be permitted to operate a DMM unit, provided that the member organization has obtained prior written approval from the Exchange.²⁰

¹⁵ The Exchange proposes to delete rule provisions that reference the terms “aggregation unit” and “integrated proprietary aggregation unit.” See, e.g., Rule 98(c)(2)(B).

¹⁶ See 17 CFR 242.200(f). Rule 200(f) of Regulation SHO sets forth the requirements for qualifying as an “independent trading unit” for the purpose of order marking requirements under Rule 200. The Commission notes that a member organization must comply with the requirements of Regulation SHO regardless of how its operations are structured for purposes of compliance with Rule 98.

¹⁷ The Exchange asserts that, because the proposed rule changes are intended to provide principles-based requirements for the operation of a DMM unit, the amended rule would no longer need to define terms, such as “customer-facing department,” that support the current, more prescriptive rule text.

¹⁸ Because these protections for Floor-based non-public order information are retained in the proposed revisions to Rule 98 and are applicable to approved persons pursuant to proposed amended Rule 98(a)(1), the Exchange asserts that current Rule 98(e), which concerns the sharing of non-trading related services, is redundant of existing regulatory requirements governing the operations of a broker-dealer.

¹⁹ The Exchange also proposes to delete the definitions of “DMM” and “approved person” as duplicative of the definitions set forth in Rules 2(i) and 2(c). The Exchange proposes to make non-substantive edits to the definition of “related products” and make conforming amendments to Rule 2(j).

²⁰ Pursuant to NYSE Rule 0, the term “Exchange” may also mean FINRA staff working on behalf of

The Exchange notes that all member organizations currently operating DMM units already have written policies and procedures to comply with Rule 98 in its current form, and such policies and procedures have been approved by NYSE Regulation.²¹ In addition, FINRA has an exam program that reviews member organizations operating DMM units for compliance with such policies and procedures. Because proposed Rule 98(a) would continue to require Exchange approval of any policies and procedures to protect against the misuse of material nonpublic information, if a member organization chose to modify its DMM operations consistent with proposed Rule 98, its revised policies and procedures would be subject to Exchange review before implementation. In addition, the Exchange represents that FINRA would continue to monitor a member organization’s compliance with those policies and procedures consistent with the current exam-based regulatory program associated with Rule 98.²²

Proposed Rule 98(c)(2) specifies that a member organization seeking approval to operate a DMM unit pursuant to Rule 98 must maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such member organization’s business, (i) to prevent the misuse of material, non-public information by such member organizations or persons associated with such member organization and (ii) to ensure compliance with applicable federal laws and regulations and with Exchange rules.²³ Proposed Rule 98(c)(2) also provides examples of conduct that would constitute the misuse of material, non-public information, including, but not limited to: (A) trading in any securities issued by a corporation, or in any related products, while in possession of material-non-public information concerning the issuer; (B)

the Exchange and NYSE Regulation, Inc. pursuant to a regulatory services agreement. The Exchange also proposes to revise Rule 98(c)(1) to replace the term “NYSE Regulation, Inc.” with the term “Exchange.”

²¹ FINRA currently approves Rule 98 procedures on behalf of NYSE Regulation, Inc. pursuant to a regulatory services agreement.

²² The Exchange represents that FINRA currently has surveillances designed to monitor for manipulative activity, and the Exchange asserts that, because DMM market-making activity is not materially different from market-making on other exchanges, these existing programs are reasonably designed to address any concerns that may be raised by a DMM unit being integrated with market-making operations.

²³ Proposed Rule 98(c)(2) is based on NYSE Arca Equities Rule 6.3 (Prevention of the Misuse of Material Nonpublic Information) and BATS Rule 5.5 (Prevention of the Misuse of Material, Non-Public Information).

¹³ NYSE OpenBook provides aggregated limit-order volume that has been entered on the Exchange at price points for all NYSE-traded securities.

¹⁴ The Exchange proposes non-substantive changes to this definition that it believes better reflect how its systems currently operate. Specifically, the Exchange asserts that concept of trading in “slow mode” is duplicative of the remaining rule text, which covers any order information that is made available to DMMs but that is not available to other market participants.

trading in a security or related product, while in possession of material non-public information concerning imminent transactions in the security or related product; 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 product for the purpose of facilitating the possible misuse of such material, non-public information.

Proposed Rule 98(c)(3) pertains to restrictions on trading for member organizations operating a DMM unit. Proposed Rule 98(c)(3)(A) would generally provide that a member organization shall protect against the misuse of Floor-based non-public order information. The rule would further specify that only the Floor-based employees of the DMM unit and individuals responsible for the direct supervision of the DMM unit's Floor-based operations may have access (as permitted pursuant to Rule 104) to Floor-based non-public order information.

Proposed Rule 98(c)(3)(B) specifies the restrictions applicable to employees of the DMM unit while on the trading floor. Proposed Rule 98(c)(3)(B)(i) provides that, while on the trading floor of the Exchange, employees of the DMM unit, except as provided for in Rule 36.30, may trade only DMM securities and may do so only on or through the systems and facilities of the Exchange, as permitted by Exchange Rules. Proposed Rule 98(c)(3)(B)(ii) would specify that, while on the trading floor, Floor-based employees may not communicate with individuals or systems responsible for making trading decisions for related products or for away-market trading in DMM securities. Proposed Rule 98(c)(3)(B)(iii) adds a new restriction that, while on the trading floor, employees of the DMM unit shall not have access to customer information or the DMM unit's position in related products.

Proposed Rule 98(c)(3)(C) would provide that a Floor-based employee of a DMM unit who moves to a location off the trading floor of the Exchange, or any person who provides risk management oversight or supervision of the Floor-based operations of the DMM unit and becomes aware of Floor-based non-public order information, shall not (1) make such information available to customers, (2) make such information available to individuals or systems responsible for making trading decisions in DMM securities in away markets or related products, or (3) use any such information in connection with making

trading decisions in DMM securities in away markets or related products. The proposed rule would cover an individual that leaves the trading floor, as well as a manager providing oversight or supervision of the Floor-based operations of the DMM unit. The Exchange's proposed amendments to Rule 98 would replace the concept of a person having "access to" information with that of a person being "aware of" information,²⁴ asserting that the change will clarify the governing standard for member organizations and make Rule 98 generally more consistent with federal rules.²⁵ The Exchange also argues that a person cannot misuse material, non-public information unless the person is "aware of" the information. Proposed Rule 98(c)(3)(C) would also maintain and consolidate the Exchange's current "wall-crossing" provisions related to a non-Floor based individual who becomes aware of Floor-based non-public order information.

Proposed Rule 98(c)(3)(D) would provide that a DMM unit may make available to a Floor broker associated or affiliated with an approved person or member organization any information that the DMM would be permitted under Exchange rules to provide to an unaffiliated Floor Broker.

Proposed Rule 98(c)(4) would provide that any interest entered by the DMM unit in DMM securities at the Exchange must be entered through systems that identify such interest as DMM interest. The Exchange asserts that it is unnecessary to prescribe or require specific systems that a DMM unit must use, but this rule would require that the DMM unit's interest be identifiable and available for Exchange review through the system that the DMM unit elects to use.

Proposed Rule 98(c)(5) would require that a member organization provide the Exchange with real-time unit position information for any trading in DMM securities by the DMM unit and any independent trading unit.²⁶ The Exchange represents that this provision should enhance its ability to monitor for

Rule 104 compliance.²⁷ For example, if a DMM unit is part of an independent trading unit that engages in trading on other markets in DMM securities, the member organization's real-time position update would need to incorporate any away-market transactions in DMM securities by that independent trading unit.

Proposed Rule 98(c)(6) would specify that a DMM unit may not operate as a specialist or market maker on the Exchange or the NYSE MKT LLC ("NYSE MKT") equities or options trading floors in related products, unless specifically permitted in Exchange rules.²⁸ The Exchange notes that a member organization that operates a DMM unit may be a specialist or market maker on NYSE MKT, provided that it maintains appropriate information barriers. Currently, Rule 98 permits an integrated proprietary aggregation unit to engage in options market making (electronic only), provided that the DMM unit is walled off from the options market making trading desk.

Proposed Rule 98(c)(7) would maintain the existing requirement that the member organization maintain information barriers between the DMM unit and any investment banking or research departments. Proposed Rule 98(c)(7) would also continue to provide that no DMM or DMM unit may be directly supervised or controlled by an individual associated with an approved person or the member organization who is assigned to any investment banking or research departments.

Proposed Rule 98(d) would specify that DMM rules would only apply to the DMM unit's quoting or trading in their DMM securities for their own accounts at the Exchange. The Exchange represents that this provision is intended to clarify that DMM rule restrictions are not applicable to any customer orders routed to the Exchange by that member organization as agent.

The Exchange proposes to delete in its entirety Rule 98(e), which concerns the sharing of non-trading related services. The Exchange states that the focus of proposed Rule 98 on protecting against the misuse of material non-public information obviates the need to specify how a member organization or an

²⁴ The concept of a person having "access to" information is incorporated into several subsections of current Rule 98. See, e.g., current Rule 98(c)(2)(E)(i), (d)(2)(B), and (f)(1)(A)(3).

²⁵ See 17 CFR 240.10b5-1(b) (specifying that a purchase or sale of securities constitutes trading on the basis of material nonpublic information when the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale).

²⁶ The Exchange proposes to delete Rule 98(d)(4) from the rule both because the Exchange does not believe it needs to separately identify DMM audit trail requirements and because Rule 132B no longer exists.

²⁷ NYSE Rule 104 obligations relate to whether a DMM is long or short and are applicable to the DMM unit's position in DMM securities, together with any position of a Regulation SHO independent trading unit of which the DMM unit may be included.

²⁸ Currently, the Exchange represents, the only time that a DMM unit may engage in market making in a related products under Exchange rules is on the NYSE MKT exchange, pursuant to NYSE MKT Rule 504(b)(5)—Equities. NYSE does not have a similar exception.

approved person provides back-office support operations, such as clearing, stock loan, and compliance, for the DMM unit. Rather, the Exchange asserts that how a member organization or approved person provides back-office operations to the DMM unit should not differ from how such services are provided to other trading units within that member organization or approved person. The Exchange also notes that, if a person in the member organization or an approved person is providing non-trading related services to the DMM unit and, as a result of such relationship, becomes aware of Floor-based non-public order information, such person would be subject to the wall-crossing provisions of proposed Rule 98(c)(3)(C), which is applicable to any person who is aware of such information. In addition, the Exchange notes that the protections for Floor-based non-public order information are retained in the proposed revisions to Rule 98 and are applicable to approved persons pursuant to proposed amended Rule 98(a)(1). The Exchange proposes conforming amendments to Rule 36.30.

As part of the proposed restructuring of Rule 98, current Rule 98(g) would be renumbered as proposed Rule 98(e), existing Rule 98(h) would be renumbered as proposed Rule 98(f), and existing Rule 98(j) would be renumbered as proposed Rule 98(g). The Exchange proposes conforming changes to these sections, such as updating cross-references and changing the rule's reference to "the Division of Market Surveillance" and "NYSE Regulation" to a reference to "the Exchange."²⁹

The Exchange proposes to delete Rule 98 Former, as well as any references thereto, because it is obsolete: All DMM firms operate pursuant to the current Rule 98.³⁰ In addition, the Exchange proposes to amend Rule 105 to delete Rule 105(b)–(d) and the Guidelines for DMM's Registered Security Option and Single Stock Futures Transactions Pursuant to Rule 105 ("Rule 105 Guidelines") and to make conforming amendments to Rule 36.30.³¹ Rule 105 currently sets forth hedging guidelines to permit a DMM to trade from the trading floor listed options or single-stock futures that overlie DMM securities. Under Rule 98(f)(1), a DMM unit can obtain an exemption from the

Rule 105 Guidelines to trade options or futures, provided that such trading is conducted by a walled-off, off-Floor trading desk.

Under the proposed revisions to Rule 98, a DMM unit would no longer need to apply for an exemption from Rule 105 trading restrictions because, as discussed above, while on the trading floor, Floor-based employees may trade only DMM securities (*i.e.*, they may not trade in related products) and may trade only on or through the systems and facilities of the Exchange. Because there would not be any Floor-based trading in listed options or single-stock futures, the Rule 105 Guidelines specifying how such Floor-based trading may occur would be moot. Accordingly, the Exchange proposes to delete these rules. To conform other Exchange rules to this proposal, the Exchange also proposes to delete section (b) from each of Rules 1300 (streetTRACKS Gold Shares), 1300A (Currency Trust Shares), and 1300B (Commodity Trust Shares). Each of these subsections cross-references Rule 105 Guidelines subsection (m) and would similarly be mooted by proposed Rule 98(c)(2)(B)(i). The Exchange proposes further conforming amendments to Rules 900(b) and (d).

In addition, because DMM units no longer have customer relationships, the Exchange proposes to delete in its entirety the DMM Booth Wire Policy, which is set forth in Rule 123B and which is now obsolete.

III. Commission Findings

After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.³² The Commission believes that the proposal is consistent with Section 6(b)(5)³³ 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.

Generally, the Exchange proposes to amend Rule 98 in order to provide DMM units with greater flexibility in structuring their operations, moving

further toward a principles-based approach and away from prescribing particular structures. Under the proposed rule change, certain information barriers would continue to be required,³⁴ but amended Rule 98 would generally contain fewer prescriptions than current Rule 98 and would instead require that a member organization operating a DMM unit maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of the member organization's business, (i) to prevent the misuse of material, non-public information by the member organization or persons associated with it and (ii) to ensure compliance with applicable federal laws and regulations and with Exchange rules.³⁵ The Exchange represents that the instant proposed rule change prescribes specific protections that reflect the unique role of DMMs and the trading floor at the Exchange, while treating the off-floor market-making activity of member organizations with DMM units similarly to the rules that govern equity market makers on NYSE Arca, Nasdaq, and BATS.³⁶

In particular, proposed Rule 98(a) provides that a member organization will be permitted to operate a DMM unit provided that the member organization has obtained prior written approval from the Exchange. The Exchange represents that, although all member organizations currently operating DMM units under Rule 98 have written policies and procedures that have been approved by NYSE Regulation, Inc., the policies and procedures of member organizations that choose to modify their DMM operations consistent with proposed Rule 98 would be subject to Exchange review prior to implementation. In addition, the Exchange represents that FINRA would continue to monitor member organizations for compliance with such policies and procedures consistent with the current exam-based regulatory program associated with Rule 98.

²⁹ See proposed Rules 98(c)(3) and 98(c)(7).

³⁰ See proposed Rule 98(c)(2).

³¹ See Securities Exchange Act Release No. 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) ("NYSE Arca Order"). See also Securities Exchange Act Release No. 61574 (Feb. 23, 2010), 75 FR 9455 (Mar. 2, 2010) (SR–BATS–2010–003) (Order approving amendments to BATS Exchange, Inc. ("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 Order").

²⁹ Pursuant to Rule 0, the reference to the Exchange in this rule may also mean FINRA.

³⁰ See, *e.g.*, NYSE Rules 98A Former, 99 Former, and 104T(a)(Former) and supplementary material .13 (Former), Rule 900, Rule 98(a) and 105.

³¹ The Exchange proposes to amend Rule 105(a) to clarify that the restriction on pool dealing applies to the DMM unit for securities registered to that unit.

³² 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).

³³ 15 U.S.C. 78f(b)(5).

Proposed Rule 98(c)(2) would replace the current, more prescriptive approach of current Rule 98 and would provide member organizations operating a DMM unit with greater organizational and operational flexibility, while still requiring that member organizations comply with their existing regulatory obligations. Specifically, proposed NYSE Rule 98(c)(2) would require a member organization seeking approval to operate a DMM unit to maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such member organization's business, (i) to prevent the misuse of material, non-public information by such member organizations or persons associated with such member organization and (ii) to ensure compliance with applicable federal laws and regulations and with Exchange rules. In addition, proposed Rule 98(c)(2) would specify that conduct constituting the misuse of material, non-public information includes, but is not limited to: (A) trading in any securities issued by a corporation, or in any related product, while in possession of material-non-public information concerning the issuer; or (B) trading in a security or related product, while in possession of material non-public information concerning imminent transactions in the security or related product; 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 product for the purpose of facilitating the possible misuse of such material, non-public information. Although the Exchange proposes to move to a more principles-based approach, and although certain information barriers may no longer be required, the Commission notes, and the Exchange acknowledges, that a member organization'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.³⁷ In addition, the Commission notes that all member organizations of the Exchange are subject to the requirements of

Section 15(g) of the Act, regardless of how their operations are structured.³⁸

The Commission notes that amended Rule 98 would delete the defined term "DMM confidential information" and would replace the defined term "non-public information" with the term "Floor-based non-public information." In the Commission's view, these definitional modifications should not reduce investor protections or market integrity. Instead, consistent with proposed Rule 98(c)(2) and Section 15(g) of the Act,³⁹ member organizations will continue to have obligations to implement reasonably designed policies and procedures to prevent the misuse of material, non-public information, and they will continue to be subject to Exchange rules regarding front-running, limit-order display, and trading ahead, as well as FINRA surveillances to detect violations of these rules.

The Commission notes that proposed Rule 98(c)(2) is substantially similar to and expressly based on NYSE Arca Rule 6.3 and BATS Rule 5.5. NYSE's market structure, however differs from that of NYSE Arca and BATS, in that the Exchange continues to have a physical trading floor. Accordingly, the Commission believes that it is appropriate that proposed Rule 98 continues to include certain prescriptions that address the role of the DMM and the trading floor in its market. Specifically, as described above, proposed Rule 98(c)(3) relates to restrictions on trading for member organizations operating a DMM unit; proposed Rule 98(c)(4) would provide that any interest entered by the DMM unit in DMM securities at the Exchange must be entered through systems that identify such interest as DMM interest; proposed Rule 98(c)(5) would require that a member organization provide the Exchange with real-time unit position information for any trading in DMM securities by the DMM unit and any independent trading unit; proposed Rule 98(c)(6) would specify that a DMM unit may not operate as a specialist or market maker on the Exchange or the NYSE MKT equities or options trading floors in related products, unless specifically permitted in Exchange rules; and proposed Rule 98(c)(7) would maintain the existing requirement that the member organization maintain

information barriers between the DMM unit and any investment banking or research departments.

Under this proposed rule change, member organizations could integrate DMM units with other trading operations within the member organization, including, if applicable, a customer-facing operation. The Commission notes that a DMM unit that is integrated with other market-making operations would be subject to existing rules that prohibit member organizations 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. For instance, NYSE Rule 5320 generally prohibits a member organization from trading for its own account ahead of customer orders, which means that a member organization operating both a DMM unit, which engages in trading for its own account, and customer-facing operations would need to comply with the Manning Rule⁴⁰ or meet one of the specified exceptions.⁴¹ Moreover, the Commission notes that (1) the Exchange has represented that FINRA currently has surveillances designed to monitor for manipulative activity, that DMM market-making activity off the trading floor is not materially different from market-making on other exchanges, and that, therefore, the existing regulatory framework is reasonably designed to address any concerns that may be raised by a DMM unit being integrated with market-making operations and (2) the Exchange has represented that FINRA currently conducts a program that approves and examines Rule 98 policies and procedures.

The Commission believes that the proposed rule change is consistent with the Act. The principles-based regulatory approach in the proposal is substantially similar to the existing regulatory approach of NYSE Arca and BATS, while also accounting for the market structure differences (*i.e.*, the role of DMM units and the trading floor on the Exchange) that raise additional regulatory and policy considerations. While proposed Rule 98 permits member organizations greater flexibility in structuring their business and compliance operations, the rule continues to require the maintenance of certain appropriate information barriers,

³⁷ This aspect of Exchange's proposal and of the Commission's findings is consistent with similar rules at other exchanges. See NYSE Arca Order at 46275 and BATS Order at 9459.

³⁸ 15 U.S.C. 78o(g). Section 15(g) of the Act requires brokers and dealers to "establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker's or dealer's business, to prevent the misuse . . . of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer."

³⁹ 15 U.S.C. 78o(g).

⁴⁰ See Manning Rule, *supra*, note 12.

⁴¹ NYSE Rule 5320 further provides that, if a member organization trades at a price for its own account ahead of the customer order, it must execute the customer order up to the size and at a price that is the same as, or better than, the price at which the organization traded for its own account.

and it clearly requires that all member organizations have policies and procedures that are reasonably designed to prevent the misuse of material, non-public information.⁴²

The Commission notes that the policies and procedures required proposed Rule 98 will be subject to oversight by the Exchange and review by FINRA, and the Commission emphasizes that a member organization operating a DMM unit should be proactive in assuring 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 and FINRA rules. Finally, the Commission notes that existing Exchange rules also prohibit particular misuses of material, non-public information—for example, front-running customer orders—and that FINRA surveillances seek to detect violations of those rules.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NYSE-2014-012), is hereby approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴³

Jill M. Peterson,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-72535; File No. SR-NYSEMKT-2014-22]

Self-Regulatory Organizations; NYSE MKT LLC; Order Approving Proposed Rule Change Amending Rule 98 To Adopt a Principles-Based Approach To Prohibit the Misuse of Material Nonpublic Information and Make Conforming Changes to Other Exchange Rules

July 3, 2014.

On March 18, 2014, NYSE MKT LLC (the “Exchange” or “NYSE MKT”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,²

filed with the Securities and Exchange Commission (the “Commission”) a proposed rule change to amend Rule 98—Equities (“Rule 98”). The proposed rule change was published for public comment in the **Federal Register** on April 7, 2014.³ On May 21, 2014, the Commission designated a longer period for Commission action on the proposed rule change.⁴ The Commission received one comment on the proposal.⁵ This order approves the proposed rule change.

I. Background and Introduction

The New York Stock Exchange LLC (“NYSE”) adopted Rule 98 (“NYSE Rule 98”) in 1986 when NYSE specialist firms, which had been independent member-owned entities, increasingly became affiliates of larger member organizations. Because of the specialists’ position in the market, Rule 98 required an organizational separation between a specialist and its affiliates. The purpose of that separation was to eliminate or control conflicts of interest between the business activities of affiliates of the specialist and the specialist’s responsibilities to the market and to any customer orders the specialist represented as agent.⁶

In 2008, the NYSE amended NYSE Rule 98 to adopt a more flexible, principles-based approach that among other things: (1) Redefined the persons to whom the Rule applied; (2) allowed DMM operations to be integrated into better-capitalized member organizations; (3) permitted a DMM unit to share non-trading-related services with its parent member organization or approved persons; and (4) provided flexibility to member organizations and their approved persons in conducting risk management of DMM operations.⁷ The principal effect of the 2008 Amendments was that affiliates of a DMM unit that were walled-off from the DMM unit were no longer prohibited from acting as an options market maker in a security in which the affiliated DMM was registered. However, the amended NYSE Rule 98 continued to prohibit the integrated unit from coordinating market making between its

DMM and its options market maker. In 2008, the Exchange (f/k/a NYSE Alternext US LLC) submitted a proposed rule change to, among other things, conform their rules to NYSE Rule 98.⁸

The Exchange now proposes to further amend Rule 98 in order to provide DMM units with greater flexibility in structuring their operations and to move further toward a principles-based approach and away from prescribing particular structures for DMM units. Under this proposed rule change, certain information barriers would continue to be required (for example, between a DMM unit and an affiliated investment-banking desk), and other required protections, in addition to information barriers, would address the role of DMMs and the trading floor in the Exchange’s market. Proposed Rule 98 would, however, contain fewer prescriptions relating to the structure of DMM units, and it would instead, like similar rules relating to market-making firms on other exchanges,⁹ impose a more general requirement that a member organization operating a DMM unit maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of the member organization’s business, (i) to prevent the misuse of material, non-public information by the member organization or persons associated with it and (ii) to ensure compliance with applicable federal laws and regulations and with Exchange rules.

The Exchange asserts that the instant proposal should provide member organizations operating DMM units with the means to better manage risk across a firm—for example, by integrating DMM unit positions and quoting information with other quotes and positions by other units within the firm. The Exchange posits that a member organization operating a DMM unit, in the context of risk management¹⁰ and consistent with protections against the misuse of material non-public information,¹¹ should be able to consider the outstanding quotes of the

⁸ See Securities Exchange Act Release No. 59022 (Nov. 26, 2008), 73 FR 73683 (Dec. 3, 2008)(SR-NYSEALTR-2008-10).

⁹ See, e.g., NYSEArca Equities Rule 6.3 and BATS Rule 5.5.

¹⁰ See e.g., 17 CFR Part 240.15c3-5 (Risk Management Controls for Brokers or Dealers with Market Access).

¹¹ See e.g., 15 U.S.C. 78o(g). Section 15(g) of the Act requires every registered broker or dealer to “establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker’s or dealer’s business, to prevent the misuse . . . of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer.”

⁴² 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.

⁴³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 71837 (Apr. 1, 2014), 75 FR 19146.

⁴ See Securities Exchange Act Release No. 72202, 79 FR 30671 (May 28, 2014).

⁵ See Email from Dr. Lee Jackson, Esq. (April 15, 2014) (“Jackson Comment”). The Commission does not believe the Jackson Comment raises any material or substantive issues.

⁶ See Securities Exchange Act Release No. 23768 (Nov. 3, 1986), 51 FR 41183 (Nov. 13, 1986) (SR-NYSE-85-25).

⁷ See Securities Exchange Act Release No. 58328 (Aug. 7, 2008), 34 FR 58328 (Aug. 18, 2008)(SR-NYSE-2008-45)(“2008 Amendments”).