

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-77332; File No. SR-NYSE-2016-16]

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change Amending Rule 98 To Provide That When Designated Market Makers Enter Interest for the Purpose of Facilitating the Execution of Customer Orders, Such Orders Would Not Be Required To Be Designated as DMM Interest

March 9, 2016.

Pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (the “Act”)² and Rule 19b-4 thereunder,³ notice is hereby given that, on March 4, 2016, New York Stock Exchange LLC (“NYSE” or the “Exchange”) 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 amend Rule 98 to provide that when Designated Market Makers (“DMM”) enter interest for the purpose of facilitating the execution of customer orders, such orders would not be required to be designated as DMM interest. The proposed rule change is available on the Exchange’s Web site 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 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 98 to provide that when DMMs enter interest on a proprietary basis for the purpose of facilitating the execution of customer orders, such orders would not be required to be designated as DMM interest.⁴

Background

In 2014, the Exchange amended Rule 98 to adopt a principles-based approach to prohibit the misuse of material nonpublic information by a member organization that operates a DMM unit and make conforming changes to other Exchange rules.⁵ Those rule changes provide member organizations operating DMM units with the ability to integrate DMM unit trading with other trading units, while maintaining tailored restrictions to address that DMMs while on the Trading Floor may have access to certain Floor-based non-public information. By removing prescriptive restrictions, the 2014 Filing was designed to enable a member organization that engages in market-making operations on multiple exchanges to house its DMM operations together with the other market-making operations, even if such operations are customer-facing, or, to enable a member organization to consolidate all equity trading, including customer-facing operations and the DMM unit, within a single independent trading unit.

Rule 98(c) sets forth specified restrictions to operating a DMM unit.⁶ Among other requirements, Rule 98(c)(4) provides that any interest entered into Exchange systems by the DMM unit in DMM securities⁷ must be identifiable as DMM unit interest. Current Rule 98(c)(4) was designed to ensure that all trading activity by a DMM unit in DMM securities at the Exchange is available for review. As

⁴ As defined in Rule 2(i), the term “DMM” means an individual member, officer, partner, employee or associated person of a Designated Market Maker Unit who is approved by the Exchange to act in the capacity of a DMM.

⁵ See Securities Exchange Act Release Nos. 72534 (July 3, 2014), 79 FR 39019 (July 9, 2014) (Approval Order) and 71837 (April 1, 2014), 79 FR 19146 (April 7, 2014) (“2014 Notice”) (SR-NYSE-2014-12) (“2014 Filing”).

⁶ As defined in Rule 98(b)(1), the term “DMM unit” means a trading unit within a member organization that is approved pursuant to Rule 103 to act as a DMM unit.

⁷ As defined in Rule 98(b)(2), the term “DMM securities” means any securities allocated to the DMM unit pursuant to Rule 103B or other applicable rules.

discussed below, under Rule 98(c)(5), DMMs would continue to be required to submit information to the Exchange to make available to the Exchange for review all trading activity by a DMM unit in DMM securities. The Exchange did not specify which system(s) a DMM unit must use because, as the Exchange’s trading systems continue to evolve, the manner by which interest would be identified as DMM interest could change. Accordingly, the current rule requires any trading for the account of the DMM unit in DMM securities at the Exchange to be identifiable as DMM interest.

Rule 98(c)(5) provides that a member organization must provide the Exchange with real-time net position information for trading in DMM securities by the DMM unit and any independent trading unit of which it is a part, at such times and in the manner prescribed by the Exchange. Rule 98(d) further specifies that the DMM rules⁸ will apply only to a DMM unit’s quoting or trading in its DMM securities for its own accounts at the Exchange. Accordingly, the DMM rules do not apply to any customer orders that a member organization that operates a DMM unit sends to the Exchange as agent.⁹

Because Rule 98(c)(4) currently requires that any interest entered into Exchange systems by the DMM unit in DMM securities be identifiable as DMM interest, a DMM unit integrated with a customer-facing unit that would send customer orders in DMM securities to the Exchange as proprietary interest must identify it as DMM interest. As a result, although agency orders are not subject to DMM rules, customer-driven interest entered on a proprietary basis is subject to all DMM rules.

To date, none of the member organizations operating a DMM have integrated a DMM unit with a customer-facing trading unit and the Exchange believes that the current rule requiring customer-driven orders that are represented on a proprietary basis be designated as DMM interest has served as a barrier to achieving such integration.¹⁰ Specifically, there are

⁸ As defined in Rule 98(b)(3), the term “DMM rules” means any rules that govern DMM or DMM unit conduct or trading.

⁹ See 2014 Notice, *supra* note 5 at 19152 (specifying that Rule 98(d) was added because DMM rules are not applicable to any customer orders routed to the Exchange by a member organization as agent).

¹⁰ The Exchange understands it is a common practice among market makers that operate as wholesalers, and thus have their own customer orders as well as retail order flow from another broker dealer, to facilitate the execution of customer order flow by representing it on a proprietary basis

¹ 15 U.S.C. 78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

certain scenarios when the rules governing DMMs may conflict with a member organization's obligations to its customers. For example, DMMs are not permitted to enter Market Orders, MOO Orders, CO Orders, MOC Order, LOC Orders, or orders with Sell "Plus"—Buy "Minus" Instructions.¹¹ But to meet customer instructions, a customer-driven order entered by a member organization on a proprietary basis may need to be one of these order types. As another example, DMMs are restricted from engaging in specified trading in the last ten minutes of trading before the close of trading.¹² But a member organization may have a best execution obligation to route a customer-driven order to the Exchange in the last ten minutes of trading.

Proposed Amendments

The Exchange proposes to amend Rule 98 to better reflect how member organizations that integrate DMM unit operations with customer-facing operations may facilitate customer-driven order flow to the Exchange in DMM securities. As noted above, one of the intended goals of the 2014 Filing was to permit member organizations to integrate DMM unit operations with other market-making operations, including customer-facing units. However, as discussed above, subjecting customer order flow that is entered on a proprietary basis to DMM rules may be inconsistent with a member organization's obligations to its customers, and thus continue to serve as a barrier to integrating DMM units within a member organization. Accordingly, the Exchange proposes to amend Rule 98 to facilitate better integration of DMM units with a member organization's existing customer-facing market-making trading units by specifying that, as with agency orders, customer-driven orders that are entered on a proprietary basis by the DMM unit would not be required to be designated as DMM interest.

The Exchange proposes to amend Rule 98 to provide that proprietary interest that is entered by a DMM unit

when such orders are routed to an exchange. Once a customer-driven order that has been represented on a proprietary basis on an exchange has been executed, the market maker uses the position acquired on the Exchange to fill the customer order either on a riskless-principal basis or with price improvement to the customer.

¹¹ See Rule 104(b)(vi).

¹² See Rule 104(g)(i)(A)(III) (defining Prohibited Transactions). Specifically, a DMM with a long position in a security is prohibited from making a purchase in a security that results in a new high price on the Exchange for the day, and a DMM with a short position in a security is prohibited from making a sale in such security that results in a new low price for the day.

for the purposes of facilitating customer orders would not be required to be designated as DMM interest. The Exchange proposes to replace the phrase "any interest" with the phrase "proprietary interest" in Rule 98(c)(4) to clarify that the existing rule only governs proprietary interest of a DMM unit, *i.e.*, interest for the account of the member organization. As further proposed, the Exchange would amend Rule 98(c)(4) to provide that if proprietary interest entered into Exchange systems by the DMM unit in DMM securities is for the purposes of facilitating the execution of an order from a customer (whether its own customer or the customer of another broker-dealer), such interest would not be required to be identifiable as DMM unit interest. The Exchange proposes to define such interest as a "customer-driven order."

The proposed definition of "customer-driven order" is not a novel concept in that other SROs rules define the concept of a proprietary order being entered to facilitate a customer order. For example, Supplementary Material .03 to FINRA Rule 5320 defines the term "facilitated order" to mean a proprietary trade that is for the purposes of facilitating the execution, on a riskless principal basis, of an order from a customer (whether its own customer or another broker-dealer).¹³ The Exchange proposes a distinction for the definition of "customer-driven order" in Rule 98 as compared to the Rule 5320 definition of "facilitated order" because as proposed, a customer-driven order would not be required to be entered on a riskless basis. Rather, the Exchange believes that any customer order that a member organization facilitates on a proprietary basis should be eligible for treatment under proposed Rule 98(c)(4).¹⁴

The proposed rule change is designed to reflect how member organizations handle customer orders, which in many circumstances, are routed to an exchange on a proprietary basis to facilitate execution of a customer's order. Therefore, the Exchange believes that the proposed amendment is consistent with the current rule, which does not require agency orders entered by the member organization that operates a DMM unit to be subject to DMM rules.¹⁵

¹³ See also Supplementary Material .03 to NYSE Rule 5320.

¹⁴ If a customer-driven order, as defined in Rule 98(c)(4), is not handled on a riskless principal basis, it would not be eligible for the riskless principal exception to the prohibition against trading ahead of customer orders as specified in Rule 5320.

¹⁵ See *supra* note 9.

The Exchange further proposes to amend Rule 98(d) to specify which rules would be applicable to trading by the DMM unit. As proposed, the rules, fees, or credits applicable to DMM quoting or trading activity would apply only to a DMM unit's quoting or trading in its DMM securities for its own account at the Exchange that has been identified as DMM interest. In addition, consistent with the proposal that customer-driven orders would not be required to be designated as DMM interest, the Exchange proposes to add text to Rule 98(d) to state that customer-driven orders for the account of a DMM unit that have not been identified as DMM interest would not be subject to DMM rules or be eligible for any fees or credits applicable to DMM quoting or trading activity.¹⁶ In addition, such customer-driven orders could not be aggregated with interest that has been identified as DMM interest for purposes of any DMM-related fees or credits or DMM quoting obligations specified in Rule 104(a). This proposed rule text would provide that customer-driven orders not designated as DMM interest would not be subject to DMM rules, which, as described above, include restrictions on availability of certain order types and entry of specified orders during the last ten minutes of trading. Because a customer-driven order that has not been designated as DMM interest would not be subject to DMM rules, it would also not be eligible for a parity allocation applicable for DMMs pursuant to Rule 72(c) or be used to assist a DMM in meeting its quoting obligations, or be eligible for DMM fees or credits.

The Rule 98(c)(5) obligation to provide the Exchange with real-time net position information in DMM securities would continue to be 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, regardless of whether they are positions resulting from trades in away markets, trades as a result of DMM interest entered at the Exchange, or customer-driven orders routed to the Exchange that were not identified as DMM interest.¹⁷ For example, if a DMM

¹⁶ Rather, such customer-driven orders would be eligible for any fees or credits applicable to equity transactions at the Exchange that are not DMM or Floor broker trades. See NYSE Price List, available here: https://www.nyse.com/publicdocs/nyse/markets/nyse/NYSE_Price_List.pdf.

¹⁷ Under Regulation SHO, determination of a seller's net position is based on the seller's position in the security in all proprietary accounts. See Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48010, n.22 (Aug. 6, 2004); see also Securities Exchange Act Release Not 48709 (Oct. 29, 2003), 68 FR 62972, 62991 and 62994

unit is combined with market-making desks that are trading on away markets and that route customer-driven orders to the Exchange in DMM securities that are not identified as DMM interest, the member organization would be required to report the position of the entire DMM unit in DMM securities, not only the DMM's Exchange-traded positions resulting from DMM interest. The Exchange also proposes a non-substantive amendment to Rule 98(c)(5) to delete the term "for trading," which the Exchange believes is extraneous rule text.

2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)¹⁸ that an Exchange have rules that are designed to promote the 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 providing greater specificity in Rule 98 regarding which proprietary interest would be required to be entered as DMM interest.

The Exchange believes that the proposed amendment to define the term "customer-driven order" to be proprietary interest of a DMM that is for the purposes of facilitating the execution of an order from a customer (whether its own customer or the customer of another broker-dealer) reflects the current reality of how broker-dealers facilitate customer orders that are routed to an exchange. Specifically, such customer orders are routed to an exchange on a proprietary basis, and once an execution is received from an exchange, the execution is provided to the customer either on a riskless principal basis or with price improvement. Facilitating customer orders on a proprietary basis is not a novel concept and serves as the basis of the definition of the term "facilitated order" in Supplementary Material .03 to FINRA Rule 5320. While the Exchange proposes that customer-driven orders for the purposes of Rule 98 would not

be required to be executed on a riskless principal basis, this difference does not alter the premise of how member organizations facilitate customer orders, as already established in Rule 5320.03. Because the proposed definition reflects how customer orders are facilitated on a proprietary basis when routed to an exchange, the Exchange believes that the proposed amendment to Rule 98(c)(4) to define the term "customer-driven order" would remove impediments to and perfect the mechanism of a free and open market.

The Exchange further believes that providing DMM units with a choice of whether to designate a customer-driven order as DMM interest would remove impediments to and perfect the mechanism of a free and open market because certain DMM rules may conflict with a broker-dealer's obligation to its customers. As discussed in the 2014 Filing, agency orders entered by a member organization that operates a DMM unit are not subject to DMM rules.¹⁹ Yet, if that same customer order were routed to the Exchange on a proprietary basis, which is the manner by which broker-dealers may handle customer order flow, it would be subject to DMM rules. Accordingly, because Rule 98 does not currently require agency flow to be subject to DMM rules, the Exchange believes it is consistent with the protection of investors and the public interest that agency flow that is facilitated by a member organization on a proprietary basis at the Exchange would similarly not be required to be subject to DMM rules.

The proposed rule change would further be consistent with the protection of investors and the public interest because it would enable customer-driven orders to not be subject to DMM rules and eliminate any conflict with customer instructions or best execution obligations.

The Exchange further believes that the proposed amendments to Rule 98(d) would remove impediments to and perfect the mechanism of a free and open market by promoting transparency in Exchange rules regarding which rules, fees or credits applicable to DMM quoting or trading activity would be applicable to which interest. More specifically, the Exchange believes that it would remove impediments to and perfect the mechanism of a free and open market to provide specificity in Exchange rules that customer-driven orders that have not been designated as DMM interest would not be subject to the DMM rules and also would not be eligible for DMM fees or credits or to be

aggregated with DMM interest for purposes of any DMM-related fees or credits or DMM quoting obligations.

Finally, the Exchange believes that the proposed amendment to Rule 98(c)(5) would remove impediments to and perfect the mechanism of a free and open market by removing extraneous rule text, thus promoting simplicity in Exchange rules.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change is designed to be pro-competitive because it would remove a restriction unique to DMMs as specified in Rule 98, thus enabling existing customer-facing market making units to operate as a DMM unit at the Exchange without needing to change the manner by which they may facilitate customer orders on a proprietary basis at an exchange.

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 respectfully requests accelerated effectiveness of this proposed rule change pursuant to Section 19(b)(2) of the Act.²⁰ The Exchange believes that there is good cause for the Commission to accelerate effectiveness because the proposed rule change is consistent with the goal of the 2014 Filing to exclude agency orders entered by a member organization that operates a DMM unit from being subject to DMM rules. The proposed rule change is designed to reflect how member organizations represent agency orders and narrowly defines a class of proprietary interest that is entered to facilitate customer orders from being required to be subject to DMM rules. Moreover, the proposed definition of "customer-driven order" is not novel, as it is based on the existing definition of "facilitated order" set forth in Supplementary Material .03 to Rule 5320 and Supplementary Material .03 to FINRA Rule 5320, which already describe how proprietary orders can be entered to facilitate a customer order.

(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); Securities Exchange Act Release No. 30772 (June 3, 1992), 57 FR 24415, 24419 n.47 (June 9, 1992); Securities Exchange Act Release No. 27938 (Apr. 23, 1990), 55 FR 17949, 17950 (Apr. 30, 1990).

¹⁸ 15 U.S.C. 78f(b)(5).

¹⁹ See *supra* note 9.

²⁰ 15 U.S.C. 78s(b)(2).

The Exchange believes that difference between the proposed Rule 98 definition of “customer-driven order” and the Rule 5320 definition of “facilitated order” is not material because, if a “customer-driven order” under Rule 98 is not executed on a riskless principal basis, it would still be subject to the requirements of Rule 5320 and would not be eligible for the riskless principal exception.

The Exchange further believes that providing DMMs with the choice of whether to designate customer-driven orders as DMM interest would permit member organizations operating DMM units to facilitate customer-based order flow at the Exchange without such orders being restricted by DMM obligations, which may be contrary to customer instructions or best execution obligations. The Exchange further believes that the proposed rule change would apply DMM rules fairly because customer-driven orders not designated as DMM interest, would not be subject to the obligations, nor be eligible for the benefits, applicable to DMM interest.

Finally, the Exchange believes there is good cause to accelerate effectiveness of this proposed rule change because it would promote competition on the Exchange. As has been previously announced, additional member organizations are seeking to become approved as DMMs.²¹ The proposed rule change would facilitate the transition of DMM responsibilities to new entrants that engage in customer-facing market making, thereby promoting competition among member organizations seeking to be approved as a DMM on the Exchange.

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period 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 Exchange consents, the Commission will:

A. by order approve or disapprove such 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 email to rule-comments@sec.gov. Please include File Number SR–NYSE–2016–16 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–2016–16. This file number should be included on the subject line if email 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 Web site (<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 Web site 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; 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–NYSE–2016–16 and should be submitted on or before April 5, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²²

Robert W. Errett,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–77333; File No. SR–BATS–2016–02]

Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Designation of a Longer Period for Commission Action on Proposed Rule Change to Rule 14.11(i), Managed Fund Shares, To List and Trade Shares of the iShares iBonds Dec 2023 AMT-Free Muni Bond ETF, iShares iBonds Dec 2024 AMT-Free Muni Bond ETF, iShares iBonds Dec 2025 AMT-Free Muni Bond ETF, and iShares iBonds Dec 2026 AMT-Free Muni Bond ETF of the iShares U.S. ETF Trust

March 9, 2016.

On January 12, 2016, BATS Exchange, Inc. (“Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b–4 thereunder,² a proposed rule change to list and trade shares of the iShares iBonds Dec 2023 AMT-Free Muni Bond ETF, iShares iBonds Dec 2024 AMT-Free Muni Bond ETF, iShares iBonds Dec 2025 AMT-Free Muni Bond ETF, and iShares iBonds Dec 2026 AMT-Free Muni Bond ETF of the iShares U.S. ETF Trust under BATS Rule 14.11(i). The proposed rule change was published for comment in the **Federal Register** on January 27, 2016.³ The Commission has not received any comments on the proposal.

Section 19(b)(2) of the Act⁴ provides that within 45 days of the publication of notice of the filing of a proposed rule change, or within such longer period up to 90 days as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding, or as to which the self-regulatory organization consents, the Commission shall either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether the

²¹ See “Citadel Securities to become #1 Designated Market Maker on NYSE,” available at <http://www.citadelsecurities.com/news/citadel-securities-become-1-designated-market-maker-nyse/>; and “GTS to become Designated Market Maker on the New York Stock Exchange,” available at <http://gtsx.com/in-the-news/details/gts-to-become-designated-market-maker-on-the-new-york-stock-exchange>.

²² 17 CFR 200.30–3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b–4.

³ See Securities Exchange Act Release No. 76954 (Jan. 21, 2016), 81 FR 4695.

⁴ 15 U.S.C. 78s(b)(2).