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February 9, 2012

By electronic submission

Ms. Jennifer J. Johnson Secretary Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue, NW Washington, D.C. 20551

Robert E. Feldman Executive Secretary Attention: Comments Federal Deposit Insurance Corporation 550 17th Street, NS Washington, D.C. 20429 Elizabeth M. Murphy Secretary Securities and Exchange Commission 100 F. Street, NW Washington, D.C. 20549-1090

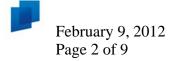
Office of Comptroller of Currency 250 E Street, SW Mail Stop 2-3 Washington, D.C. 20219

Re: Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Docket No. R-1432 and RIN 7100 AD 82 (Board of Governors); Docket ID OCC-2011-014 (OCC); RIN3064-AD 85 (FDIC); and File No. S7-41-11 (SEC))

Dear Sir or Madam:

NYSE Euronext, on behalf of its wholly-owned subsidiaries, the New York Stock Exchange LLC ("NYSE"), NYSE Amex LLC ("NYSE Amex"), and NYSE Arca Inc. ("NYSE Arca") (collectively, the "Exchanges"), appreciates the opportunity to comment on the proposed common rule of the Office of Comptroller of Currency, Federal Reserve Board , Federal Deposit Insurance Corporation and Securities Exchange Commission ("SEC")(collectively, the "Agencies") that would implement Section 619 (the "Volcker Rule Proposal" or "Proposal") of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). As the operator of three major U.S. securities exchanges, NYSE Euronext is keenly

Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).



interested in the implementation of the Volcker Rule Proposal.² Specifically, we enthusiastically support an exemption from the proprietary trading restrictions of the Act for market making-related activities.³ However, we believe that the exemption in the Proposal is too narrowly defined and, if adopted, would unnecessarily restrict and make more costly market making-related activities that have been long recognized by the Congress, regulators, exchanges, and market participants as critical to market liquidity and capital formation.

In particular, we are concerned with aspects of the Proposal that, if not flexibly applied, would restrict the ability of market makers to accumulate and manage inventory positions, and cause an undue emphasis on the source and nature of revenues and fees in determining whether activity is related to market making or prohibited proprietary trading. We believe that one unintended consequence of this would be an adverse impact on the liquidity of the nation's securities markets, which would harm investors and companies needing efficient access to capital.

Market Making Generally. Market making and market making-related activities are critical to the functioning of the U.S. financial markets and make up a meaningful percentage of market volume. While the precise contours of market making vary by type of instrument, asset class and segment of the market, a few general characteristics have been acknowledged over the years and, indeed, are described in the Proposing Release and other governmental reports related to the Proposal. First and foremost, market making is focused on meeting the needs of customers. Market makers accomplish this by (i) providing two sided quotes (at or near both sides of the market for an instrument), (ii) holding themselves out as willing to buy and sell, (iii) engaging in a pattern of purchases and sales in a manner that provides liquidity, and (iv) in some cases, widely disseminating quotations or otherwise broadly disseminating their trading interest. As a result all investors, including retail investors, often rely on market makers for pricing transparency.

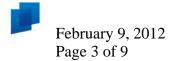
In sum, market makers act as buyers and sellers to meet the demand of investors. Indeed, market makers registered with the Exchanges are required to contribute to the maintenance of fair and orderly markets, including contributing to price continuity and minimizing disparities

See "Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds", Securities Exchange Act Release No. 65545 (Oct. 12, 2011), 76 Fed. Reg. 68,846 (Nov. 7, 2011) ("Proposing Release").

We note that the Act contains the explicit intent to preserve market-making activity. See Section 619(d)(1)(B) of the Act.

For example, equity options market making accounted for 48% of the market volume during the month of November 201; *See* "Volume Options Query Report" (available at http://www.theocc.com/webapps/volume-query). It has been estimated by the TABB Group that equities market making accounted for 32% of U.S. market volume in 2011.

See "Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds;" Financial Stability Oversight Council (January 2011) at pp. 28-29.



between supply and demand.⁶ In doing so, market makers, registered or otherwise, assume risk and securities positions that they manage over time frames that vary depending on the security and market conditions.

Overview of the Market Making Exemption. Section 13 of the Bank Holding Company Act ("BHC Act") generally prohibits "banking entities" from engaging in proprietary trading or acquiring or retaining any ownership interest in, or sponsoring a covered fund. Under the BHC Act and the Proposal, "proprietary trading" includes engaging as principal for the "trading account" of a covered banking entity in any purchase or sale of one or more "covered financial positions." A "trading account" generally is defined as any account used by a covered banking entity to acquire covered financial positions for short-term resale, benefit from short term price movements or realize short-term arbitrage profits. 10

Section 13(d)(1) of the BHC Act exempts from the general prohibition on proprietary trading certain permitted activities including, among others, market making-related activities. ¹¹ The Volcker Rule Proposal sets forth a number of conditions relevant to determining that a purchase or sale of a covered financial position is in connection with a covered banking entity's market making-related activities including, among others, that the activities are designed to generate revenues primarily from fees, commissions, bid/ask spreads or other income not attributable to appreciation in the value of covered financial positions held in trading accounts, or the hedging of such positions. ¹² As a result, the Proposal effectively

For example, market makers registered with the NYSE (denoted as "designated market makers" or "DMMs") have an obligation to, among other things, use their own capital to contribute to the maintenance of a fair and orderly markets and maintain a bid or an offer at the National Best Bid or National Best Offer for a certain percentage of the trading day. *See* NYSE Rule 104; *see also* Securities Exchange Act Release No. 58848 (Oct. 24, 2008), 73 Fed. Reg. 64,379 (Oct. 29, 2008) ("SEC Approval Order of NYSE New Market Model").

A "banking entity" generally includes any insured depository institution, any company that controls an insured depository institution, any company treated as a bank holding company for purposes of the International Banking Act of 1978, and ay affiliate or subsidiary of such companies. [Subpart A, § __.2(e).]

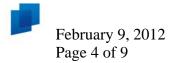
Under the Act, nonbank financial companies supervised by the Board that engage in proprietary trading or covered fund activities may be subject to additional capital requirements. *See* Proposing Release *supra* note 2 at 68847.

BHC Act Section ___; [Subpart B, Section ___.3] A covered financial position includes any position in a security, derivative or future (or option on any such instrument. [Subpart B, Section __.3(b)(3).]

BHC Act Section ___; [Subpart B, Section ___.3] A covered financial position includes any position in a security, derivative or future (or option on any such instrument. [Subpart B, Section __.3(b)(3).]

In addition to the express requirements for permitted market making-related activities, certain covered financial positions are deemed within the exemption for market making-related activities if they are used to hedge risks associated with permitted market making activities.

Other conditions to relying on the exemption for market maker-related activities include: (A) the covered banking entity must have established an internal compliance program required by proposed rule; (B) the trading desk conducting the purchase or sale must hold itself out as willing to buy and sell the covered financial position for its own account on a regular or continuous basis; (C) the activities



imposes limitations on the types of revenues that may be received by firms engaged in market making-related activities (the "Revenue Limitation"), as well as limitations on the accumulation of inventories by such firms (the "Inventory Limitation").

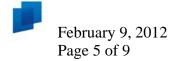
Subpart B of the Proposal includes several quantitative measures that will be used to assess firms' compliance with the Revenue and Inventory Limitations. We appreciate the acknowledgement by the Agencies that no single quantitative measurement can accurately identify proprietary trading without further analysis of the related facts and circumstances. However, a full understanding of the activities engaged in by market makers will be critical to this analysis. As discussed below, we believe that the Revenue Limitation and the Inventory Limitation in the Proposal are overly restrictive in light of traditional market making and market making-related activities, including, in many instances, activities conducted by market makers registered with the Exchanges.

The Proposed Revenue and Inventory Limitations are Too Restrictive. The Revenue and Inventory Limitations are premised on the view that market makers engage in transactions that generate fees, commissions or spreads as payment for their services. This requirement apparently is intended to ensure that activities conducted in reliance on the exemption for market making-related activities are tied to customer intermediation and liquidity services, rather than changes in the value of positions held in inventory. These criteria, however, understate the extent to which market making and market making-related activities generate other forms of revenue and require the maintenance of inventory in many instances. Indeed, holding inventory (and revenue related thereto) is an important aspect of all facets of bona fide market making activity, from providing liquidity in the face of order imbalances and market volatility, to facilitating large trades, to hedging positions acquired in the course of market making.

<u>Assumption of Risk</u>. The proposed restrictions on earning revenue from the appreciation in the value of covered financial positions fail to fully recognize the extent of risk involved in market making-related activities. ¹³ Market makers are required to take positions to facilitate

conducted must be designed not to exceed the reasonably expected near term demands of clients, customers or counterparties; (D) with respect to covered financial positions that are securities, the covered banking entity must be registered with the SEC as a dealer under Section 15(a) of the Exchange Act or exempt from registration as a dealer (or is engaged in the business of a dealer outside the U.S. and subject to substantive regulation outside the U.S.); (E) the compensation arrangements for persons engaged in market making must be designed not to reward proprietary risk taking; and (F) the activities must be consistent with the commentary provided in Appendix B of the Proposal. *See* 12 U.S.C. 1851(d)(1)(B); *see also* Proposing Release *supra* note 2 at 68,866 – 68,868.

The proposed Revenue and Inventory Limitations also presume that market makers on exchanges primarily earn revenue by posting passive orders for execution. However, when there are order imbalances on the Exchanges market makers will do more than just "passively" submit resting orders. For example, market makers often use market orders to lessen volatility and restore pricing to equilibrium. Market makers also use market orders or marketable limit orders to hedge their position risks and to create markets. Therefore, passive submission of resting orders should not be a required indicator of legitimate market making-related activity.



liquidity when there is an imbalance in customer buying and selling demand. Market makers correct these imbalances by immediately taking the other side of trades and holding the positions as inventory while attempting to find liquidity to offset their risk. This is true of the highly liquid NYSE-listed equities and options markets, as well as the fixed income, derivatives and other less liquid markets. Indeed, as noted above, the Exchanges have imposed affirmative obligations on registered market makers for decades, requiring them to maintain fair and orderly markets and to minimize the effects of temporary disparities between supply and demand. In doing so, market makers assume risk positions that may accumulate profits or losses, depending upon trending of market prices and the ability of the market maker to effectively liquidate or hedge its position. Thus, this accumulation of profits or losses is a direct consequence of the provision of liquidity to customers and not evidence of proprietary trading.

This is particularly true in volatile markets, where the activities of market makers not only help meet market demand, but also can help dampen volatile conditions. For example, in the immediate aftermath of September 11, 2001, market makers were a significant source of market liquidity. Similarly, during the particularly volatile conditions of our markets in 2008, market makers were instrumental players on our markets. During these volatile times, it is likely that market makers generated profits and losses from changes in prices of their underlying positions entered as part of their market making-related activity; not because they engaged in proprietary trading.

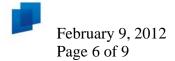
Market makers also assume position risk in providing liquidity to customers with block-sized trades. ¹⁵ Often market makers will purchase an entire block of shares from a customer and hold them in inventory until it is able to sell them without incurring a significant loss. For example, a market maker may purchase all of the stock offered by a customer seeking to sell \$100 million in stock of a single equity issuer with a market capitalization of \$1,000,000,000. In facilitating the ability of the customer to quickly sell such a large block of stock, the market maker may hold in inventory that portion of the purchased shares that it cannot resell without driving down the price of the stock. The value of this position may change with movements in the market price of the stock, but that does not change the fundamental market making nature of the transaction. However, if the Proposal is adopted, the inability of market makers to earn revenue associated with changes in the prices of block trade inventory positions may well result in higher costs to investors, as market makers may determine to charge higher fees to offset the risk incurred if required to liquidate block positions more quickly than otherwise warranted by market conditions. ¹⁶ This may be particularly true with respect to positions in less liquid securities.

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See e.g., NYSE Rule 104, NYSE Arca Options Rule 6.37, and NYSE Amex Rule 925NY.

NYSE Rules define a block as at least 10,000 shares or a quantity of stock having a market value of \$200,000 or more, whichever is less. NYSE Rule 104(a)(5).

Block trades are a significant source of NYSE volume. Block trades on the NYSE accounted for 16.3% of shares traded (300 billion shares, or 1.3 billion a day) and 13.3% of total dollar volume (\$7.9 trillion, \$34.4 billion a day) of total market volume year-to-date through November 2011. Such trades



Principal trading by market makers in large size also is essential in some stocks. For example, principal trading in creation unit size by authorized ETF participants is essential to the liquidity of that market, as well as to maintaining the efficient pricing between ETFs and their underlying baskets of securities. The ETF market has been one of the fastest, if not the fastest, growing financial markets in recent years, offering tremendous benefits to investors.

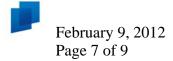
Hedging Risk. The Revenue and Inventory Limitations of the Proposal also do not recognize the extent to which market makers routinely acquire positions to hedge the inventory they accumulate in facilitating customer transactions (as discussed above). To minimize the risks associated with holding such inventory, market makers seek to use the most appropriate and efficient hedging instruments. The best hedge for any particular risk will vary tremendously depending on the size, nature and other characteristics of the relevant product and its market. Sometimes, the best hedge involves a variety of complex and dynamic transactions over the time in which the asset is held, and such hedging transactions may fall outside the permissible parameters established by the Proposal. By constraining the flexibility of market makers in choosing the most effective hedge, the Revenue and Inventory Limitations will increase risk, and hence, trading costs for market makers. Increasing the cost of market making ultimately results in higher costs for investors, including investors trading securities listed on the Exchanges.

Adverse Consequences for Market Making Activity. In sum, market makers take inventory positions in the normal course of engaging in market making-related activities.¹⁷ They may well receive profits (or losses) from changes in the prices of securities that make up these positions. By limiting the permissible revenues and inventory positions associated with market making-related activities, the Revenue and Inventory Limitations will adversely impact the ability or willingness of firms to engage in market making – particularly with respect to less liquid securities. This will have a significant and adverse impact on the liquidity available to investors and, concomitantly, the ability of companies to raise needed capital. Congress clearly recognized that market making involves risk and position taking during the course of adopting the Act, and that limiting such activity would have these

frequently exceed \$5 million in total volume – over 600 times the size of the standard trade in the market.

Although now stabilizing, block trading has declined in recent years due to the wide spread use of algorithmic trading strategies by institutional traders to divide large trades into several smaller trades to manage market impact and risk. While smaller orders tend to require less capital, market makers must still provide liquidity to support these investor-driven trades. According to TABB Group, buy side order flow allocated to algorithms and direct market access accounted for 37% of buy-side executed volume in 2011, with the remaining 42% to the sales desk, 11% to crossing networks and 10% to programs. *See* TABB Group; U.S. Equity Trading 2011/12: Coverage Under Fire; November 2011.

The Inventory Limitation will have a different impact on various markets. For example, options market makers, in particular, may hold positions in equities underlying options for longer periods of time as part of their hedging strategies. Additionally, making markets in illiquid instruments often necessitates holding inventory for longer periods of time.



significant adverse consequences.¹⁸ The Proposal, however, goes too far, and fails to follow through on congressional intent to not "unduly constrain banking entities in their efforts to safely provide such [market-making] services." Therefore, we urge the Agencies to reconsider the Revenue and Inventory Limitations.

The Proposal Does Not Recognize the Extent to Which Market Marking-Related Activities Involve the Payment of Fees. Subpart B of the Rule Proposal indicates that, absent explanatory facts and circumstances, trading activity in which a trading unit routinely pays rather than earns fees, commissions or spreads will be considered to be prohibited proprietary trading, and not permitted market making.²⁰ This proposed requirement, however, fails to recognize that market makers routinely pay a variety of fees, commission and spreads in connection with their bona fide market making-related activities. For example, the equity markets, in particular, while highly competitive, are fragmented, making it difficult for customers to access all pockets of liquidity. To satisfy customer demand for liquidity, market makers may pay fees for accessing liquidity on other markets.²¹ Market makers also may pay transaction fees as a matter of course. For example, many options exchanges, including NYSE Amex, directly charge market makers transaction fees. 22 Stock and options market makers alike also regularly pay fees in connection with their hedging transactions with noncustomers. Given that market makers routinely pay fees as they conduct their market makingrelated activities, we urge the Agencies to reconsider the proposed limitation on the payment of fees, commission or spreads. It is also worth noting that requiring market makers to continually rely on the facts and circumstances exceptions in the rule could significantly increase the compliance burden. For example, if a market maker hedges using correlated instruments that involves liquidity taking and the paying of fees, and continually had to document this activity in order to prepare for regulatory inquiries regarding it, that market maker might conclude that the administrative costs of compliance is too high to continue providing liquidity in that instrument.

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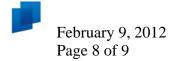
In the colloquy between Senator Bayh and Chairman Dodd, Chairman Dodd affirmed that the market making—related permitted activity "would allow banks to maintain an appropriate dealer inventory and residual risk positions, which are essential parts of the market making function. Without that flexibility, market makers would not be able to provide liquidity to markets." 156 CONG. REC. S5902 (daily ed. July 15, 2010) (statement of Sen. Bayh).

See Proposing Release supra note 2 al at 68,849.

We note that, although the ability to earn bid/ask spreads constitutes a significant component of market maker revenue, there is substantial volatility in spreads in today's rapidly moving markets. Therefore, short term measurements of profit compared to spread revenue is problematic, particularly for less liquid stocks.

Such access fees are recognized in Rule 610 of Regulation NMS, as well as in the linkage plan among options exchanges. 17 C.F.R. § 240.610, and Plan for the Purpose of Creating and Operating an Intermarket Option Linkage.

See NYSE Amex Options Fee Schedule (available at http://www.nyse.com/pdfs/NYSEAmex_Options_Fee_Schedule.pdf).

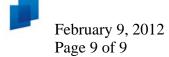


Trading of Exchange Market Makers Should be Presumed to Satisfy Requirements of Market Making Exemption. The Proposal notes that, in evaluating the availability of the exemption for market making-related activities, the status of being a registered market maker is not, on its own, a sufficient basis for relying on the exemption. We understand that whether a firm is engaging in market making-related activity under the exemption will involve a facts and circumstances analysis. However, we believe that some recognition should be afforded to the affirmative obligations of market makers to facilitate liquidity and fair and orderly markets under the rules of the various securities exchanges, as well as the oversight of market makers by exchanges in their self-regulatory capacities. Thus, while we agree that status as a registered exchange market maker should not necessarily be conclusive of engaging in market making-related activities, we believe that such status should convey a presumption of eligibility for the exemption.

The Proposal Would Adversely Impact Capital Formation. As stated previously, market makers play a critical role in facilitating liquidity and maintaining stable and orderly markets. Of course, the depth and liquidity of our secondary trading markets directly impact the ability and willingness of issuers to list their securities as a means of raising necessary capital. Absent deep and liquid secondary markets, the cost of capital in the primary markets will rise and capital formation will suffer, to the ultimate detriment of U.S. businesses and investors. Moreover, if it is too costly for U.S. (and foreign) corporations to raise capital in the U.S., they will list their securities in foreign markets. The Agencies should foster strong and liquid U.S. markets by avoiding overly restrictive regulations that hobble market makers in their efforts to provide the liquidity so essential to our markets.

Any Specific Metrics Should Be Applied Flexibly. We recommend that the Agencies provide greater flexibility in the application of the proposed metrics for assessing the availability of the exemption for market making-related activities. We are concerned that many of the factors to be applied by the Agencies to determine bona fide market making will introduce uncertainty into market making activity, significantly impacting the willingness of firms to engage in this important activity. For example, the after-the-fact application of quantitative measurements such as the Comprehensive Profit and Loss, and Comprehensive Profit and Loss to Volatility Ratio – two of several means of determining whether revenue is generated primarily by customer-related activities or price movements of retained principal risk, or the Pay-to-Receive Ratio used to determine the appropriate level of fees earned versus fees paid by market makers – may cause firms to reconsider their commitment to market making. To the extent these measures are utilized under the Proposal, they should be applied flexibly, in light of market conditions prevailing during the relevant time period, and as one of many factors relevant to an overall assessment of bona fide market making. Flexible application of metrics and appropriate compliance regime will be more effective ways to enforce prohibitions on proprietary trading while maintaining important market making-related activity that banking entities perform on exchanges.

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Phased Implementation of the Proposal Will Facilitate an Orderly Transition in the Markets. Lastly, we recommend that the Agencies adopt a phased-in implementation approach. Providing a phased-in implementation will alleviate potential disruption to the markets.

Conclusion. We appreciate the opportunity to comment on this important proposal. In light of the important role of market makers in our markets, we need to take particular care to ensure that any rules that further complicate and limit the ability of market makers to provide the liquidity to the market are narrowly tailored and flexibly applied. We would be happy to discuss the matter further with any of the Agencies and their respective staff.

Very truly yours,

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