

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55883)

June 8, 2007

Order Exempting Certain Print Protection Transactions from Rule 611 of Regulation NMS under the Securities Exchange Act of 1934

I. Introduction

Pursuant to Rule 611(d)¹ of Regulation NMS² under the Securities Exchange Act of 1934 (“Exchange Act”), the Securities and Exchange Commission (“Commission”), by order, may exempt from the provisions of Rule 611 of Regulation NMS (“Rule 611” or “Rule”), either unconditionally or on specified terms and conditions, any person, security, transaction, quotation, or order, or any class or classes of persons, securities, quotations, or orders, if the Commission determines that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.³ As discussed below, the Commission is exempting from Rule 611(a) certain transactions that offer print protection to displayed customer orders when trades are reported at prices inferior to such orders. The exemption is designed to promote efficiency and the best execution of investor orders by allowing trading centers to offer beneficial executions to their customers that have offered liquidity that is immediately and automatically accessible in the public markets, without the trading centers incurring additional costs to meet the requirements of Rule 611(a).

¹ 17 CFR 242.611(d).

² 17 CFR 242.600 et seq.

³ See also 15 U.S.C. 78mm(a)(1) (providing general authority for the Commission to grant exemptions from provisions of the Exchange Act and rules thereunder).

II. Background

The Commission adopted Regulation NMS in June 2005.⁴ Rule 611 addresses intermarket trade-throughs of displayed quotations in NMS stocks. Rule 611(a)(1) requires a trading center to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs on that trading center of protected quotations in NMS stocks that do not fall within an exception set forth in the Rule. Rule 611(b)(6) provides an exception for a trade-through transaction effected by a trading center that simultaneously routes an intermarket sweep order (“ISO”) to execute against the full displayed size of any protected quotation in the NMS stock that was traded through. Rule 611(b)(5) provides an exception for a trade-through transaction that is an execution of an ISO. Finally, Rule 611(c) requires that the trading center, broker, or dealer responsible for the routing of an ISO take reasonable steps to establish that such order meets the definition of an ISO in Rule 600(b)(30).⁵

The Trading Committee of the Securities Industry and Financial Markets Association (“SIFMA”) has requested that the Commission exempt certain print protection transactions from Rule 611(a).⁶ According to the SIFMA Exemption Request, print protection is the mechanism through which broker-dealers may elect to execute a displayed order at a price that is better than a reported trade in the same security on a different market.⁷ The ability of broker-dealers to offer print protection to orders will become more difficult under Rule 611 when the price of the print protection transaction is inferior to one or more protected quotations at the time of execution.

⁴ See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (“Regulation NMS Adopting Release”).

⁵ 17 CFR 242.600(b)(30).

⁶ Letter to Nancy M. Morris, Secretary, Commission, from Jerry O’Connell, Chairman, SIFMA Trading Committee, dated May 1, 2007 (“SIFMA Exemption Request”).

⁷ Id. at 2.

The SIFMA Exemption Request asserts that, absent an exemption, broker-dealers will not be able to provide print protection to orders in these circumstances.

As an example, the SIFMA Exemption Request supposes that Firm A represents an order to buy 1000 shares at \$49.90, and it is displayed on Automated Trading Center X, which currently shows a top-of-book (“TOB”) protected bid of \$50 for 1000 shares. Automated Trading Center Y shows a TOB protected bid of \$49.80 for 1000 shares. A broker-dealer wants to sell 2000 shares, and it sends an ISO to sweep the TOB protected quotes across the automated trading centers. The 1000 shares at \$50 at Automated Trading Center X are filled, and the 1000 shares at \$49.80 at Automated Trading Center Y are filled. In contrast, the order represented by Firm A and displayed on Automated Trading Center X does not receive a fill, even though its \$49.90 price is better than the \$49.80 order executed by Automated Trading Center Y, because the \$49.80 quote was the TOB in Automated Trading Center Y. Firm A wants to provide print protection for its customer and execute the displayed order but, depending on the new national best protected bid and offer, filling the order at \$49.90 may violate Rule 611.

When customer orders contribute to price discovery by being displayed in whole or in part, SIFMA believes that broker-dealers should be allowed to elect to execute these orders for their customers without violating Rule 611.⁸ It asserts that the requested exemption will promote greater price discovery in the securities markets by encouraging the display of limit orders. The requested exemption would be available for a broker-dealer that offers its customers print protection to use at the broker-dealers’ election, and broker-dealers would not be required to provide print protection.

⁸ Id. at 4.

III. Discussion

The Commission has decided to exempt trading centers from the requirement in Rule 611(a) to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs when the transaction that constituted the trade-through is the execution of an order that meets the following terms and conditions (“Print Protection Transaction”):

- (1) The order is displayed in whole or in part by an automated trading center (as defined in Rule 600(b)(4) of Regulation NMS) that directly displays protected quotations (as defined in Rule 600(b)(57) of Regulation NMS);
- (2) After the order is displayed, a transaction (“Triggering Transaction”) is reported pursuant to a transaction reporting plan (as defined in Rule 600(b)(32) of Regulation NMS) at a price that is inferior to the price of the displayed order;
- (3) The Triggering Transaction is reported as qualifying for the exception for ISOs in paragraphs (b)(5) or (b)(6) of Rule 611;
- (4) The trading center executes the order promptly after the Triggering Transaction is reported;
- (5) The contra side of the execution of the order is provided by a broker-dealer who has responsibility for the order;
- (6) The size of the transaction does not exceed the total of the displayed size and reserve size of the order displayed on the automated trading center; and
- (7) The trading center establishes, maintains, and enforces written policies and procedures that are reasonably designed to assure compliance with the terms of this exemption,

and the trading center regularly surveils to ascertain the effectiveness of such policies and procedures and takes prompt action to remedy deficiencies in them.

The exemption applies only to the execution of the Print Protection Transaction itself. It does not, for example, apply to any trades executed by the trading center that are connected with the Print Protection Transaction.

The Commission believes that an exemption for Print Protection Transactions will promote efficiency and the best execution of investor orders.⁹ The exemption will allow trading centers to execute Print Protection Transactions without a requirement to prevent trade-throughs of the current protected quotations or to qualify for one of the exceptions in Rule 611(b). It thereby will minimize the expense incurred by trading centers to offer beneficial transactions to customers when such customers have contributed to public price discovery by displaying trading interest at a price and offering immediately accessible liquidity at such price.

Promoting the display of customer limit orders and public price discovery were primary objectives of Rule 611.¹⁰ The trade-through protection of Rule 611, however, is limited to the best bids and offers (“BBOs”) displayed by automated trading centers. The Commission did not adopt a proposal to extend trade-through protection to certain “depth-of-book” quotations outside a trading center’s BBOs, but noted that a number of commenters believed that enhanced order interaction with depth-of-book quotations would likely result even if the proposal were not adopted.¹¹ These commenters asserted that competition and best execution responsibilities would lead market participants to voluntarily access depth-of-book quotations in addition to

⁹ See Exchange Act Section 11A(a)(1)(C)(i) and (iv) (assuring efficient execution of securities transactions and the practicability of executing investors’ orders in the best market are two of the primary objectives for the national market system).

¹⁰ See, e.g., NMS Adopting Release, 70 FR at 37501.

¹¹ NMS Adopting Release, 70 FR at 37530.

quotations at BBOs. The Commission noted that such a competition-driven outcome would benefit investors and the markets in general.¹²

Print protection offered by trading centers is an additional competition-driven factor that can improve the execution of depth-of-book quotations and thereby promote price discovery. The Commission therefore believes that the exemption is fully consistent with the policies of Rule 611. The terms of the exemption are designed to achieve this goal. The customer's order must be displayed in whole or in part by an automated trading center that displays protected quotations. An automated trading center is required to offer immediate and automatic access to its displayed quotations, including both the displayed size and any reserve (i.e., undisplayed) size of such quotations.¹³ The size of a Print Protection Transaction cannot exceed the total of the displayed size and reserve size of the customer's order. Given that those who seek to trade in large size often are unwilling to display the full extent of their trading interest because of the risk of causing an adverse price movement, the Commission believes it is appropriate to allow Print Protection Transactions to protect both displayed size and reserve size of customer orders. As a result, customers will be rewarded for displaying some of their trading interest at a particular price, while also providing immediately available liquidity at such price that is undisplayed.¹⁴ Finally, the trading center must execute the Print Protection Transaction promptly after the Triggering Transaction, the contra side of the execution of the order must be provided by a

¹² Id.

¹³ See Rule 600(b)(4)(i) (automated trading center must be capable of displaying automated quotations); Rule 600(b)(3)(ii) (automated quotation must be immediately and automatically accessible); Regulation NMS Adopting Release, 70 FR at 37534 n. 313 (automated quotation “must be immediately and automatically accessible up to its full size, which will include both the displayed and reserve size of the quotation”).

¹⁴ See NMS Adopting Release, 70 FR at 37514 (noting common use of “pinging” orders – marketable orders with sizes greater than displayed size that seek to access both displayed and reserve liquidity at automated trading centers).

broker-dealer who has responsibility for the order, and the Triggering Transaction must be identified as qualifying for the ISO exceptions in paragraphs (b)(5) or (b)(6) of Rule 611. These exceptions indicate that ISOs were routed to execute against all protected quotations with prices superior to the price of the Triggering Transaction, but may not have satisfied the full extent of the customer's order. If they did not, the trading center will be allowed to offer print protection and give the customer's order a beneficial execution.

For the foregoing reasons, the Commission finds that granting the foregoing exemption is necessary and appropriate in the public interest, and is consistent with the protection of investors.

IV. Conclusion

IT IS HEREBY ORDERED, pursuant to Rule 611(d) of Regulation NMS, that trading centers shall be exempt from the requirement in Rule 611(a) to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs when the transaction that constituted the trade-through qualifies as an Print Protection Transaction, as defined above.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Florence E. Harmon
Deputy Secretary

¹⁵ 17 CFR 200.30-3(a)(82).