Financial Industry Regulatory Authority

February 23, 2016

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Nos. SR-FINRA-2015-047 and SR-BATS-2015-108 – Response to Comments

Dear Mr. Fields:

This letter responds to comments received by the Securities and Exchange Commission ("SEC" or "Commission") to the above-referenced rule filings, which relate to proposed rules by FINRA and the BATS Exchange, Inc. ("BATS") to implement the quoting and trading requirements of the National Market System Plan to Implement a Tick Size Pilot Program ("Plan" or "Pilot").[1] Capitalized terms used herein, but not otherwise defined, shall have the meanings ascribed to them in the Plan.

Background

On August 25, 2014, the Participants filed with the Commission, pursuant to Section 11A of the Act[2] and Rule 608 of Regulation NMS thereunder,[3] the Plan to Implement a Tick Size Pilot Program.[4] The Participants filed the Plan to comply with an

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1 See Securities Exchange Act Release Nos. 76483 (November 19, 2015), 80 FR 73853 (November 25, 2015) (File No. SR-FINRA-2015-047) (Notice of Filing of a Proposed Rule Change to Adopt FINRA Rule 6191(a) to Implement the Quoting and Trading Requirements of the Regulation NMS Plan to Implement A Tick Size Pilot Program) ("FINRA Proposal") and Securities Exchange Act Release No. 76552 (December 3, 2015), 80 FR 76591 (December 9, 2015) (SR-BATS-2015-108) (Notice of Filing of a Proposed Rule Change to Adopt Rule 11.27 to Implement the Quoting and Trading Requirements of the Regulation NMS Plan to Implement A Tick Size Pilot Program) ("BATS Proposal"), together "FINRA and BATS Proposals."

2 15 U.S.C. 78k-1.

3 17 CFR 242.608.

4 See Letter from Brendon J. Weiss, Vice President, Intercontinental Exchange, Inc., to Secretary, Commission, dated August 25, 2014.

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order issued by the Commission on June 24, 2014.[5] The Plan was published for comment in the Federal Register on November 7, 2014, and approved by the Commission, as modified, on May 6, 2015.[6]

The Plan is designed to allow the Commission, market participants, and the public to study and assess the impact of increment conventions on the liquidity and trading of the common stock of small-capitalization companies. Each Participant is required to comply, and to enforce compliance by its member organizations, as applicable, with the provisions of the Plan.

The Plan provides for the creation of a group of Pilot Securities, which shall be placed in a control group and three separate test groups, with each subject to varying quoting and trading increments. Pilot Securities in the control group will be quoted at the current tick size increment of $0.01 per share and will trade at the currently permitted increments. Pilot Securities in the first test group will be quoted in $0.05 minimum increments but will continue to trade at any price increment that is currently permitted.[7] Pilot Securities in the second test group ("Test Group Two") will be quoted in $0.05 minimum increments and will trade at $0.05 minimum increments subject to a midpoint exception, a retail investor order exception, and a negotiated trade exception.[8] Pilot Securities in the third test group ("Test Group Three") will be subject to the same quoting and trading increments as Test Group Two, and also will be subject to the "Trade-at" requirement to prevent price matching by a market participant that is not displaying at the price of a Trading Center's "Best Protected Bid" or "Best Protected Offer," ("PBBO") unless an enumerated exception applies.[9] In addition to the exceptions provided under Test Group Two, an exception for Block Size orders and exceptions that mirror those under Rule 611 of Regulation NMS[10] will apply to the Trade-at prohibition.

The Commission approved the Pilot on a two-year basis, with implementation to begin no later than May 6, 2016.[11] On November 6, 2015, the SEC exempted the Participants from implementing the pilot until October 3, 2016.[12]

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5 See Securities Exchange Act Release No 72460 (June 24, 2014), 79 FR 36840 (June 30, 2014).

6 See Securities Exchange Act Release No. 74892 (May 6, 2015), 80 FR 27513 (May 13, 2015) ("Approval Order").

7 See Section VI(B) of the Plan.

8 See Section VI(C) of the Plan.

9 See Section VI(D) of the Plan.

10 17 CFR 242.611.

11 See Approval Order at 27533 and 27545.

12 See Securities Exchange Act Release No. 76382 (November 6, 2015), 80 FR 70284 (November 13, 2015) (File No. 4-657).

On October 9, 2015, New York Stock Exchange LLC ("NYSE") filed with the Commission a proposed rule change to implement the Plan.[13] On November 13, 2015, FINRA filed with the Commission a proposed rule change to adopt FINRA Rule 6191(a) to implement the quoting and trading requirements of the Plan.[14] On November 30, 2015, BATS filed with the Commission a proposed rule change to adopt BATS Rule 11.27(a) to implement the quoting and trading requirements of the Plan.[15]

Comment Letters

FINRA and BATS received two identical comment letters in response to their proposed rule changes.[16] FINRA and BATS also separately received one comment letter each specific to their proposed rule changes.[17] Responses by FINRA and BATS to those comments are set forth below.

1. Trade-at Prohibition

Proposed FINRA Rule 6191(a)(6) and BATS Rule 11.27(a)(6) set forth the applicable quoting and trading restrictions for Pilot Securities in Test Group Three, including the "Trade-at" prohibition. The proposed Rule provides that no member may display, rank, or accept from any person any displayable or non-displayable bids or offers, orders, or indications of interest in any Pilot Security in Test Group Three in increments other than $0.05. The rules also state that, absent any of the applicable exceptions, no member that operates a Trading Center may execute orders in any Pilot Security in Test Group Three in price increments other than $0.05. The $0.05 trading increment will apply to all trades, including Brokered Cross Trades.

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13 See Securities Exchange Act Release No. 76229 (October 22, 2015), 80 FR 66065 (October 28, 2015) (SR-NYSE-2015-46) ("NYSE Proposal").

14 See FINRA Proposal, supra note 1.

15 See BATS Proposal, supra note 1.

16 See Letter from T.R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association ("SIFMA"), to Robert W. Errett, Deputy Secretary, SEC, dated December 18, 2015 ("SIFMA Letter"); and letter from Brendon J. Weiss, Co-Head, Government Affairs, Intercontinental Exchange, Inc., and John K. Kerin, Chief Executive Officer, Chicago Stock Exchange, Inc. to Robert W. Errett, Deputy Secretary, SEC, dated January 15, 2016 ("NYSE/CHX Letter").

17 See Letter from Mary Lou Von Kaenel, Managing Director, Financial Information Forum, to Robert W. Errett, Deputy Secretary, SEC, dated December 16, 2015 ("FIF FINRA Letter"); and letter from Mary Lou Von Kaenel, Managing Director, Financial Information Forum, to Robert W. Errett, Deputy Secretary, SEC, dated December 22, 2015 ("FIF BATS Letter")

Proposed FINRA Rule 6191(a)(6)(D) and BATS Rule 11.27(a)(6)(D) set forth the "Trade-at Prohibition," which is the prohibition against executions by a member that operates a Trading Center of an order at the price of a protected quotation during regular trading hours, absent any of the exceptions set forth in FINRA Rule 6191(a)(6)(D) and BATS Rule 11.27(a)(6)(D). The first exception to the Trade-at Prohibition is the "display exception," which allows a trade to occur at the price of the Protected Quotation, up to the Trading Center's full displayed size, if the order "is executed by a trading center that is displaying a quotation."[18] Consistent with the Plan, the proposed Rule reiterates that a member that operates a Trading Center that is displaying a quotation, via either a processor or an SRO quotation feed, that is at the price of a Protected Bid or Protected Offer is permitted to execute orders at that level, but only up to the amount of its displayed size. A member that operates a Trading Center that was not displaying a quotation that is the same price as a Protected Quotation, via either a processor or an SRO quotation feed, is prohibited from price-matching protected quotations unless an exception applies.

Under the FINRA and BATS Proposals, the display exception applies to trades executed by a Trading Center otherwise than on an exchange where the Trading Center has previously displayed a quotation in either an agency, riskless principal or principal capacity. Specifically, a Trading Center that is displaying a quotation as agent or riskless principal may only execute as agent or riskless principal, while a Trading Center displaying a quotation as principal (excluding riskless principal) may execute either as principal or agent or riskless principal.

NYSE's proposed version of the display exception differs from the FINRA and BATS Proposals in that, under the NYSE proposal, the display exception would be limited to principal quotations for the account of the Trading Center seeking to use the exception, and would not permit members to execute in an agency or riskless principal capacity based upon agency or riskless principal quotes. Proposed NYSE Rule 67(e)(4)(C) would allow a member organization to execute an order at the price of a protected quotation if the order is executed by a Trading Center within a member organization that has displayed a quotation for the account of that Trading Center on a principal basis, via either a processor or an SRO Quotation Feed, at a price equal to the traded-at Protected Quotation. If the Trading Center has satisfied the display exception, the Trading Center may execute the order up to the full displayed size of its displayed quote. In its filing, NYSE stated that, "[b]y requiring the displayed quotation to be for the account of 'that Trading Center,' the Trading Center cannot rely on any quotations it

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18 In FINRA Rule 6191(a)(6)(D) and BATS Rule 11.27(a)(6)(D) FINRA and BATS propose that a member that utilizes the independent aggregation unit concept may satisfy the display exception only if the same independent aggregation unit that displays interest via either a processor or an SRO Quotation Feed also executes an order in reliance upon this exception. Under the proposed rules, "independent aggregation unit" has the same meaning as provided under Rule 200(f) of SEC Regulation SHO. See 17 CFR 242.200.

may put up on an agency basis, including a riskless principal basis. A Trading Center that is a broker-dealer also cannot rely on any quotation that is not a displayed quotation for its own account, such as the quotation of another broker-dealer, or customer of such broker-dealer."[19]

FIF, SIFMA and NYSE/CHX commented on FINRA and BATS's proposed display exception. FIF and SIFMA supported FINRA and BATS's proposals as preferable to the NYSE/CHX approach. SIFMA also stated that the Plan Participants should work together to harmonize their proposals, as the current lack of coordination will have a direct impact on the amount of time market participants will have to implement the proposed rule changes.[20]

In their comment letter on the FINRA and BATS Proposals, NYSE and CHX disagreed with FINRA's and BATS's version of the display exception, stating that the FINRA and BATS Proposals would create an incentive for trading in Test Group Three to migrate to dark venues, undermining the Commission's stated goal in its Order approving the Plan.[21] NYSE and CHX stated that the FINRA and BATS Proposals would allow price matching based on a quotation in an agency capacity and that an alternative trading system ("ATS") would be permitted to execute matched trades of any of its participants at the Traded-at Protected Quotation if it is displaying, on an agency basis, a quotation of another participant at the Protected Quotation. NYSE and CHX further stated that, given that all participant orders displayed by an ATS are agency orders of that ATS, and trades matched by ATS participants without display are also agency orders of that ATS, the FINRA and BATS Proposals would allow market participants to "free ride" on the protected quotation of another ATS participant that is displayed on an agency basis by the ATS, and create a loophole to Test Group Three.[22] According to NYSE and CHX, trading behaviors for Test Group Three would end up similar to trading behaviors for Test Group Two, undermining the utility of the Tick Size Pilot to provide quality data to test the incremental impact of Test Group Three on displayed liquidity and market quality when compared to Test Groups One and Two.[23]

FINRA and BATS disagree with the NYSE and CHX characterization of the operation of the display exception as set forth in the FINRA proposal, and confirm that a broker-dealer would not be permitted to trade on the basis of interest that it is not responsible for displaying. FINRA and BATS would view a broker-dealer that matches orders in the over-the-counter ("OTC") market, as principal, agent or riskless principal, to have "executed" such orders as a Trading Center for purposes of Rule 6191, regardless of

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19 See NYSE Proposal, 80 FR at 66067.

20 See SIFMA Letter at 3.

21 See NYSE/CHX Letter at 6.

22 See NYSE/CHX Letter at 6.

23 See NYSE/CHX Letter at 6-7.

whether such broker-dealer ultimately executes and reports such trade through an OTC trade reporting facility, an ATS or another Trading Center. Accordingly, if a broker-dealer has displayed, as principal, a buy order at the protected bid on an exchange or Electronic Communications Network ("ECN") prior to its receipt of a customer sell order, it could internalize that customer sell order, up to its displayed size, in reliance on the FINRA Rule 6191(D)(ii)(a) and BATS Rule 11.27(a)(6)(D)(ii)(a) exceptions. If, however, that broker-dealer has not displayed a principal buy order at the protected bid, but matches its customer order with an order for its own account and submits the paired orders to an ECN where another broker-dealer is displaying a buy order at the protected bid, the broker-dealer submitting the paired orders could not rely on the proposed display exceptions. While the ECN, as a Trading Center, could execute the displayed order as agent with offsetting interest because it was displaying an agency quotation at the protected bid, the broker-dealer submitting the paired orders could not, as a Trading Center, trade with its customer order , because it was not displaying a principal quotation at the protected bid. Accordingly, such a transaction could not be effected consistent with the Trade-at Prohibition under FINRA and BATS's Proposals.

FINRA and BATS agree it is important that the industry have a uniform and consistent iteration of the operation of the display requirement from Plan Participants, and continue to believe that the FINRA and BATS Proposals are consistent with the Plan as approved by the SEC. FINRA and BATS believe that the display exception set forth in the FINRA and BATS Proposals is a targeted and balanced approach that is consistent with the Plan and the objective of the Trade-at Prohibition, which is to promote the display of liquidity and generally to prevent any Trading Center that is not quoting from price-matching Protected Quotations.

2. Requests for Clarification

a. Re-Pricing Orders

In its comment letter, FIF seeks clarification on the proposed treatment of a variety of order types. Specifically, FIF seeks clarification as to (1) how exchanges will treat Good Till Cancel orders that were entered before the beginning of the Pilot in non-nickel increments, and remain unexecuted at the beginning of the Pilot Period; (2) whether indications of interest priced to execute at the mid-point may be entered in increments of less than $0.05; and (3) whether Market Maker peg order limit prices are required to be in $0.05 increments.[24]

FINRA and BATS note that two of these requests for clarification are best addressed by the Participants collectively, especially since the questions pertain to the treatment of orders by exchanges. To that end, FINRA, BATS and the other Participants are drafting a series of Frequently Asked Questions that will address these and other questions. With respect to whether indications of interest priced to execute at the mid-

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[24] See FIF FINRA Letter at 2; FIF BATS Letter at 3.

point may be entered in increments of less than $0.05, FINRA and BATS note that Test Group One permits orders priced to execute at the midpoint may be ranked and accepted in increments of less than $0.05.

b. Odd Lots

FIF also seeks clarification with respect to the application of Trade-at to odd lots. FIF notes that odd lots are not protected quotations and therefore are not covered by either the trade-through provision of Regulation NMS, or by the Trade-at prohibition. In terms of whether an odd lot may be allowed to be executed at the price of a protected quotation, regardless of whether it has satisfied the other requirements of the Trade-at prohibition, FIF notes that Rule 611 dos not apply to odd-lot orders or to the odd-lot portions of mixed-lot orders.[25] To the extent that the Participants intended to model the Trade-at prohibitions up on the Rule 611 exceptions, FIF requests that a member be permitted to execute an odd lot order at the price of the protected quotation under any circumstance, e.g., the odd lot order would not have to meet any of the proposed exceptions to Trade-at.[26]

FINRA and BATS do not believe that there is a basis for creating a separate exception for odd-lots from the Trade-at prohibition and therefore a Trading Center would be prevented from executing an odd lot order at the price of a protected quotation unless an exception applies. FINRA and BATS note that while odd lots are not protected quotes, a Trading Center displaying an odd lot order via an SRO feed would be able to execute the odd lot order based on such display and the price and size requirements of the Trade-at prohibition. FINRA, BATS, and the other Participants are also drafting a series of Frequently Asked Questions that will further address this question.

c. Block Size Orders

The proposed rules by FINRA and BATS implementing the Trade-at prohibition except Block Size orders and permit Trading Centers to trade at the price of a Protected Quotation, provided that the order is of Block Size at the time of origin and is not an aggregation of non-block orders, broken into orders smaller than Block Size prior to submitting the order to a Trading Center for execution; or executed on multiple Trading Centers.[27] In requiring that the order be of Block Size at the time of origin and not an aggregation of non-block orders, or broken into orders smaller than Block Size prior to

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25 See SEC Division of Trading and Markets, Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS, FAQ 7.03 (April 4, 2008).

26 See FIF FINRA Letter at 3.

27 The Plan defines "Block Size" as an order (1) of at least 5,000 shares or (2) for a quantity of stock having a market value of at least $100,000.

submitting the order to a Trading Center for execution; or executed on multiple Trading Centers, FINRA and BATS stated that it is providing clarity as to the circumstances under which a Block Size order will be excepted from the Trade-at Prohibition.

In its comment letters, FIF stated that this provision would prevent Trading Centers from facilitating a block cross that includes smaller orders, in addition to block size orders. FIF therefore requested that FINRA and BATS amend this provision to permit the aggregation of non-block orders, as long as at least one component of the block in itself would constitute a Block Size order as defined in the Plan.[28]

FINRA and BATS do not believe that such an exception would be consistent with the Plan. Permitting the aggregation of non-block orders, or permitting members to combine a block with non-block orders, would overly broaden the scope of the Block Size exception and may create a means by which members could undermine this exception.[29]

d. Other Regulation NMS Exceptions

FIF also proposed that the Participants incorporate two additional exceptions to the Trade-at prohibition which currently apply to Rule 611. FIF requested that the Participants incorporate an exception for certain error correction transactions, and an exception for certain print protection transactions.

FINRA and BATS note that the Trade-at prohibition and its accompanying exceptions are based on Rule 611, and, in consultation with the other Participants, have determined that it is appropriate to incorporate the error correction exception to the Trade-at prohibition. Accordingly, certain transactions to correct bona fide errors in the execution of customer orders will be exempted from the Trade-at prohibition, subject to the conditions set forth in the SEC's order exempting these transactions from Rule 611.[30]

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28 See FIF FINRA Letter at 4; FIF BATS Letter at 3.

29 FINRA and BATS also note that FIF made a similar comment in connection with the NYSE proposal. NYSE responded that FIF's proposed expansion of the Block Size exemption is inconsistent with the Plan, as it would allow a broker-dealer with a single block size order to add, on the same side of the trade, unlimited non-block orders and execute under the block size exemption. See NYSE / CHX Letter at 8.

30 With respect to the correction of bona fide errors, the Trading Center must effect the transaction solely to correct a "bona fide error," which is defined as: (i) the inaccurate conveyance or execution of any term of an order including, but not limited to, price, number of shares or other unit of trading; identification of the security; identification of the account for which securities are purchased or sold; lost or otherwise misplaced order tickets; short sales that were instead sold long or vice versa; or the execution of an order on the wrong side of a market; (ii) the unauthorized or unintended purchase, sale, or allocation of securities, or the

FINRA and BATS do not believe that it is appropriate to adopt a print protection exemption to Trade-at. A print protection exception in the trade-at context could only be possibly applicable in scenarios where a customer order was not fully displayed. In its order exempting print protection transactions from Rule 611, the SEC noted that this exception would allow trading centers to provide beneficial executions to customers that displayed liquidity and thereby contributed to price discovery.[31] FINRA and BATS note that one of the stated objectives of the Trade-at requirement is to promote the display of

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failure to follow specific client instructions; (iii) the incorrect entry of data into relevant systems, including reliance on incorrect cash positions, withdrawals, or securities positions reflected in an account; or (iv) a delay, outage, or failure of a communication system used to transmit market data prices or to facilitate the delivery or execution of an order. Second, the bona fide error must be evidenced by objective facts and circumstances, and the Trading Center maintains documentation of such facts and circumstances. Third, the Trading Center must record the transaction in its error account. Fourth, the Trading Center must establish, maintain, and enforce written policies and procedures that are reasonably designed to address the occurrence of errors and, in the event of an error, the use and terms of a transaction to correct the error in compliance with this exemption. Fifth, the Trading Center must regularly surveil to ascertain the effectiveness of its policies and procedures to address errors and transactions to correct errors and takes prompt action to remedy deficiencies in such policies and procedures. See Order Exempting Certain Error Correction Transactions from Rule 611 of Regulation NMS under the Securities Exchange Act of 1934, Securities Exchange Act Release No. 55884 (June 8, 2007), 72 FR 32926 (June 14, 2007).

31 See Securities Exchange Act Release No. 55883 (June 8, 2007), 72 FR 32927 (June 14, 2007). The SEC required print protection transactions to satisfy the following requirements in order to qualify for the exception: (1) the order is displayed in whole or in part by an automated trading center that directly displays protected quotations; (2) after the order is displayed, a transaction ("Triggering Transaction") is reported pursuant to a transaction reporting plan 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 (a)(6)(D)(ii)(h) or (a)(6)(D)(ii)(i) of FINRA Rule 6191; (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. See Securities Exchange Act Release No. 55883 (June 8, 2007), 72 FR 32927 (June 14, 2007).

liquidity, and believe that creating a print protection exemption to Trade-at that would only be applicable when customer orders were not fully displayed would undermine this objective. Based on experience with print protection transactions under Rule 611, FINRA and BATS also believe that such an exception, even if created, would be rarely used. Given that Trade-at requires a Trading Center to execute against a protected quotation of equal price absent an exception, FINRA and BATS also believe that, in the absence of a print protection exception to Trade-at, a Trading Center would also be required to execute against better-priced liquidity in this scenario.[32]

e. Trade-at Prohibition and Manning Rule

FIF also seeks clarification with respect to the application of FINRA's Rule 5320 (Prohibition Against Trading Ahead of Customer Orders or "Manning"), which governs trading ahead of customer orders, in the context of the Trade-at prohibition. In one example given by the FIF (Scenario 1), the Trading Center receives a customer buy order for 400 shares at $10.10, and facilitates this order by executing against protected offers at $10.00, $10.05, and $10.10. If the Trading Center then fills the customer buy order on a riskless principal basis at an average price of $10.05, FIF queries whether the Trading Center would be obligated to send ISOs to execute against the protected offers in allocating the fill to the customer.[33] FINRA believes that the second leg of a riskless principal transaction that compiles with the relevant conditions of the SRO riskless principal provisions would not constitute a separate transaction for purposes of complying with Rule 611.[34] Similarly, FINRA believes that the second leg of a riskless

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32 For example, absent a print protection exemption to Trade-at, assume that Market Maker A is holding a customer order to buy 1,000 shares at $49.90, of which 500 is displayed and 500 is in reserve. Exchange A is displaying a bid at $50.00 x 1,000, and a bid at $49.90 x 500 (which represents Market Maker A's display portion of its 1,000 share order). Exchange B is displaying a bid at $48.80 x 1,000. Market Maker B originates an order to sell 2,000 shares and sends ISOs to Exchange A and Exchange B and executes their quotes of $50.00 and $48.80, respectively. Pursuant to Rule 611(a)(5), the 2,000 shares are printed as ISOs. Immediately thereafter but before Market Maker A can execute the customer order, Exchanges C and D update their quotes as follows: Exchange C displays a bid at $50.00 x 1,000 and Exchange D displays a bid at $49.90 x 100. Market Maker A would like to execute the full 1,000 share order. Under Trade-at, with no print protection exception, Market Maker A would not be permitted to execute the undisplayed portion of the customer order unless it sends required ISOs to both the better and same priced protected quotes in effect at the time Market Maker A executed the undisplayed portion of the customer order.

33 See FIF FINRA Letter at 6.

34 See SEC Division of Trading and Markets, Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS, FAQ 3.04 (April 4, 2008).

principal transaction should not constitute a separate transaction for purposes of complying with the Trade-at prohibition. In filling the customer order in this example, the Trading Center would not therefore need to send out ISOs to execute against the protected offers in order to comply with the Trade-at prohibition.

In another example given by the FIF (Scenario 2), the Trading Center receives a customer buy order for 200 shares at $9.95 and a customer sell order for 200 shares at $9.95. Under Manning, if a member executes the customer buy order for 200 shares at $9.95 as principal, the Trading Center then has an obligation to fill the customer sell order at $9.95. To the extent that an exchange is displaying a bid of $9.95 for 200 shares, FIF seeks clarification as to whether the Trading Center would have to route an ISO to execute the customer sell order against the displayed order on the exchange.[35] In this example, the Trading Center is able to satisfy its obligations under both the Trade-at prohibition and its obligations under Rule 5320 by routing a Trade-at ISO to execute against the displayed order on the exchange.[36] FINRA believes that, in this example, a member is able to comply both with the Trade-at prohibition and Rule 5320.

In another example provided by FIF (Scenario 3), the Trading Center fills a customer buy order for 200 shares at $9.954 pursuant to the negotiated price exception, and has a customer sell order for $9.95. Pursuant to Rule 5320, the Trading Center is required to fill the customer order to sell 200 shares with a limit price of $9.95. The FIF seeks to clarify whether the Trading Center may execute the customer sell order at $9.954, even though the Plan requires, absent an applicable exception, that the order be executed in an increment of $0.05.[37] FINRA, in consultation with the other Participants, believes that it is appropriate to amend the quoting and trading requirements of Groups Two and Three address the issues raised in Scenario 3. FINRA will therefore propose to add an exception to permit members to fill a customer order in a Pilot Security in Test Group Two or Three at a non-nickel increment to comply with FINRA Rule 5320 under limited circumstances.

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35 See FIF FINRA Letter at 6-7.

36 The Plan defines a Trade-at ISO as a limit order for a Pilot Security that, when routed to a trading center, is identified as an Intermarket Sweep Order, and simultaneous with the routing of the limit order identified as an Intermarket Sweep Order, one or more additional limit orders, as necessary, are routed to execute against the full displayed size of any protected bid, in the case of a limit order to sell, or the full displayed size of any protected offer, in the case of a limit order to buy, for the Pilot Security with a price that is equal to the limit price of the limit order identified as an Intermarket Sweep Order. These additional routed orders also must be marked as Intermarket Sweep Orders. See Plan, Section I(MM).

37 See FIF FINRA Letter at 7.

FIF also posed a scenario (Scenario 4) where a member principally fills a customer buy order for 200 shares at $9.949 pursuant to the negotiated price exemption and consequently, pursuant to FINRA Rule 5320, owes a fill to a customer order to sell 200 shares with a limit price of $9.95.[38] FIF requests that FINRA confirm that the member may principally fill the customer sell order for 200 shares at a price of $9.95 without sending an ISO to NYSE against its displayed quote of 200 shares at $9.95. FINRA disagrees that the member may principally fill a customer order for a Group 3 security at the price of a Protected Quotation where the member is not displaying at the price of a Protected Quotation, unless an exception applies. Thus, unless another exception is available to the member, the member must route a Trade-at ISO to the exchange to fill the customer sell order.

f. Trade-at Prohibition and Undisplayed Interest and Oversize ISOs

FIF seeks clarification on the Trade-at prohibition as it applies to undisplayed interest and oversize ISOs. In one example given by the FIF illustrating the undisplayed interest scenario, there are protected bids at $20.00 and $19.90, and the Trading Center has hidden interest at $20.00. If that Trading Center receives a sell order with a limit price of $19.90, FIF seeks clarification that the Trading Center is not obligated to execute against its undisplayed interest at $20.00, but may instead execute against the displayed interest at $20.00, the displayed interest at $19.90, and then fill the remainder of the order at $19.90.[39]

FINRA notes that undisplayed interest does not constitute a protected quote,[40] and that the display exception, by definition, only applies to displayed interest. Although the Trade-at prohibition therefore does not require a Trading Center to execute against undisplayed interest, FINRA notes that other rules may govern the Trading Center's analysis in this example.

FIF also seeks clarification on the application of the Trade-at prohibition as it applies to oversize ISOs where the exchange's order book contains both displayed and undisplayed interest. In one example given by the FIF, an exchange is displaying 500 shares at $20.00 (the protected best bid), and has an additional 500 shares undisplayed at $20.00. If the broker sends an ISO to the exchange to sell 1000 shares, FIF queries whether the exchange would be able to execute against that order in its entirety without an obligation to route out.[41]

In this example, broker sends an ISO to the exchange. If the broker has submitted a Trade-at ISO to the exchange, as defined in the Plan, the broker is also required to route

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38 See FIF FINRA Letter at 7.

39 See FIF FINRA Letter at 10.

40 See 17 CFR 242.600(b)(57).

41 See FIF FINRA Letter at 10.

limit orders to execute against the full displayed size of any protected bid with a price that is equal to the limit price identified in the Trade-at ISO ($20). If the broker has, in fact, executed against all displayed liquidity at $20 and routes a 1000 share Trade-at ISO at $20 to the exchange, the exchange may execute against its displayed and undisplayed interest at $20, as the Trade-at ISO indicates to the exchange that the broker has executed against the other protected quotations at that price, thereby satisfying the Trade-at requirements.

g. Market Maker Principal Executions

FIF also poses a question relating to whether Market Makers are obligated to send ISOs in connection with executing against Market Maker interest. In the example provided by FIF, the Market Maker is quoting on Nasdaq at $10.00 x 10.05 for 100 shares each, and receives a 500 share order to buy at $10.05. FIF asks whether the Market Maker can fill the entire 500 share order at $10.05 without sending an ISO.[42] A Trading Center or Market Maker is not obligated to trade against its quote that is displayed on an exchange, so in this example, the Market Maker would not be obligated to route an ISO to Nasdaq to execute against its displayed interest. FINRA notes, however, that to the extent that the Market Maker is only displayed for 100 shares, the Market Maker can only execute 100 shares of the incoming order unless the Market Maker also executed against any other protected quotation at that price.

h. Not-Held Orders and Market Maker Principal Executions

FIF notes that, based upon guidance issued in connection with the Plan, Market Makers should not increase their quote upon receipt of an order so that they may provide a principal execution without accessing the displayed market.[43] In the case of a long-lived not-held order, FIF asks whether it is possible for Market Makers to permissibly adjust their quote over the life of the quote, given that the order may be filled through a variety of means, e.g., agency algorithm, principal/riskless principal fills, an agency cross, etc.[44]

FINRA believes that, as long as the Market Maker does not intentionally update its quote for the sole purpose of executing a customer order it is holding, quote updates during the life of a Not Held order would be permissible and that the Market Maker would be permitted to execute part of the order at its current displayed price and size, even if such price and size were the result of a quote update that occurred after receipt of the customer order. FINRA would expect, however, that Market Makers have policies and procedures in place to prohibit quote updates after the receipt of an order specifically

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42 See FIF FINRA Letter at 11.

43 See FIF FINRA Letter at 11.

44 See FIF FINRA Letter at 11.

for the purpose of allowing the Market Maker to execute the order at the price of a protected quote.

i. Stopped Trade Exception

FIF seeks to clarify the application of the block trade exception and the stopped trade exception. The Rule 611 stopped trade exemption applies where "[t]he price of the trade-through transaction was, for a stopped buy order, lower than the national best bid in the NMS stock at the time of execution or, for a stopped sell order, higher than the national best offer in the NMS stock at the time of execution."[45] The Trade-at stopped trade exception applies where "the price of the Trade-at transaction was, for a stopped buy order, equal to the national best bid in the Pilot Security at the time of execution or, for a stopped sell order, equal to the national best offer in the Pilot Security at the time of execution."[46]

To illustrate its point, FIF uses an example where the NBB is $10.00 and another protected quote is at $9.95. A stopped order to buy can be filled at $9.95 and the firm does not have to send an ISO to access to protected quote at 10 since, under Rule 611, the price of the stopped order must be lower than the National Best Bid. Since, however, the stopped order exception for Trade-at requires the price of the stopped buy order to be equal to the National Best Bid, the firm would have to send an ISO to access the protected bid at $9.95. In order for the order to be executed at $9.95, the Trade-at prohibition for stopped orders would have to be revised to allow at order to execute at the price of a protected quote (even if such protected quotation is inferior to the National Best Bid) which, in this case, could be $9.95. Based on this result, FIF questions whether the stopped trade at exemption should be modified to apply where the price of the Trade-at transaction was, for a stopped order, equal to a protected bid or offer.[47]

FINRA and BATS, in consultation with the other Participants, believes that it is appropriate to amend the stopped trade exception to address the above example. FINRA and BATS will therefore propose to amend the stopped trade exception to allow a stopped trade to satisfy the Trade-at requirement if the stopped trade price is equal to a protected quotation that is the next best-priced bid or offer.

j. Handling of Institutional or Retail Customer Orders Priced in Impermissible Trading Increments

FIF also seeks clarification as to whether, if a non-FINRA member customer routes an electronic order in a Pilot Security to a member with a limit price other than a

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45 See 17 CFR 242.611(b)(9).

46 See Plan, Section VI(D)(12).

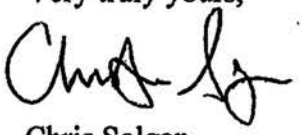
47 See FIF FINRA Letter at 11.

nickel, the member may round the limit price down to the nearest valid increment, or whether the member must reject the order.[48]

FINRA notes that firms are not permitted to change the price or terms of a customer order without the informed consent of the customer. Accordingly, whether a member may round the limit price down to the nearest valid increment will depend upon the specific communication between the member and the customer.

FINRA and BATS believe that the foregoing responds to the issues raised by the commenters.[49] If you have any questions, please contact either of us at the below numbers.

Very truly yours,



Andrew Madar
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FINRA

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BATS

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48 See FIF FINRA Letter at 12.

49 In addition to responding to the comments and requests for clarification raised in the FIF's comment letters and Appendices, FINRA and BATS note that they are engaged in a continuing discussion with FIF and with other industry participants on the issues raised in the FIF's comment letters and Appendices.