

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68808; File No. SR-FINRA-2013-012)

February 1, 2013

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Extend the Clearly Erroneous Pilot Period and to Adopt a New Provision in Connection with the Limit Up-Limit Down Plan

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 30, 2013, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by FINRA. FINRA has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,<sup>3</sup> which renders the proposal effective upon receipt of this filing by the Commission. 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 the Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA Rule 11892 (Clearly Erroneous Transactions in Exchange-Listed Securities) to extend the effective date of the clearly erroneous pilot, which is currently scheduled to expire on February 4, 2013. FINRA also proposes to adopt new supplementary material in connection with the upcoming operation of the Plan to Address Extraordinary Market Volatility Pursuant to Rule 608 of SEC Regulation NMS (the “Limit Up-

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

Limit Down Plan” or “Plan”).<sup>4</sup>

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA 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, FINRA 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 these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

FINRA proposes to amend FINRA Rule 11892 (Clearly Erroneous Transactions in Exchange-Listed Securities) (the “Rule”) to extend the effective date of the amendments set forth in File No. SR-FINRA-2010-032 (the “clearly erroneous pilot”), which are currently scheduled to expire on February 4, 2013,<sup>5</sup> until September 30, 2013, and to adopt new Supplementary Material .03 in connection with the upcoming operation of the Limit Up-Limit Down Plan.

Proposal to Extend Pilot

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<sup>4</sup> See Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (the “Limit Up-Limit Down Release”).

<sup>5</sup> See Securities Exchange Act Release No. 67579 (August 2, 2012), 77 FR 47467 (August 8, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2012-038).

On September 10, 2010, the Commission approved, on a pilot basis, changes to the self-regulatory organizations' ("SROs") clearly erroneous rules, including FINRA Rule 11892, to provide for uniform treatment: (1) of clearly erroneous execution reviews in multi-stock events involving twenty or more securities; and (2) in the event transactions occur that result in the issuance of an individual stock trading pause by the primary market and subsequent transactions that occur before the trading pause is in effect for transactions otherwise than on an exchange.<sup>6</sup> FINRA also adopted additional changes to the Rule as part of the clearly erroneous pilot that reduced the ability of FINRA to deviate from the objective standards set forth in the Rule. FINRA believes the benefits to market participants derived from this more-objective clearly erroneous rule should continue on a pilot basis through September 30, 2013, which is the date that FINRA anticipates that the phased implementation of the Limit Up-Limit Down Plan will be complete.

As explained in further detail below, although the Limit Up-Limit Down Plan is intended to prevent executions that would need to be deemed erroneous, FINRA believes that certain protections should be maintained while the industry gains initial experience operating with the Limit Up-Limit Down Plan, including the provisions of Rule 11892 that currently operate as a pilot.

#### Proposed Limit Up-Limit Down Provision for Rule 11892

FINRA proposes to adopt new Supplementary Material .03 to provide that the existing provisions of Rule 11892 will continue to apply to all over-the-counter transactions involving an exchange-listed security reported through a FINRA system, including transactions in securities subject to the Plan, other than as set forth in proposed Supplementary Material .03. Accordingly,

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<sup>6</sup> See Securities Exchange Act Release No. 62885 (September 10, 2010), 75 FR 56641 (September 16, 2010) (Order Approving File No. SR-FINRA-2010-032).

other than as proposed below, FINRA proposes to maintain and continue to apply the clearly erroneous standards as it does today. Notably, this means that FINRA might deem as clearly erroneous transactions that occur within the price bands disseminated pursuant to the Limit Up-Limit Down Plan to the extent such transactions qualify as clearly erroneous under existing criteria.

As an example, assume that a Tier 1 security pursuant to the Plan has a reference price of \$100.00 pursuant to both the Plan and Rule 11892. The lower price band under the Plan would be \$95.00 and the upper price band under the Plan would be \$105.00. An execution could occur otherwise than on an exchange in this security at \$96.00, as this is within the Plan's price bands. However, if subjected to review as potentially clearly erroneous, FINRA would deem an execution at \$96.00 as clearly erroneous because it exceeds the 3% threshold that is in place pursuant to Rule 11892(b)(1) for securities priced above \$50.00 (i.e., with a reference price of \$100.00, any transactions at or below \$97.00 or above \$103.00 could be deemed clearly erroneous). Accordingly, this proposal maintains the status quo with respect to reviews of clearly erroneous transactions and the application of objective numerical guidelines by FINRA. The proposal does not increase the discretion afforded to FINRA in connection with reviews of clearly erroneous transactions.

The Limit Up-Limit Down Plan is designed to prevent executions from occurring outside of dynamic price bands disseminated to the public by the single plan processor as defined in the Limit Up-Limit Down Plan.<sup>7</sup> The possibility remains that a member may experience a technology or systems problem that results in the occurrence of an over-the-counter transaction in an exchange-listed security outside of the applicable price bands. To address this possibility,

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<sup>7</sup> See Limit Up-Limit Down Release, supra note 4.

FINRA proposes to adopt language to make clear that if a member's technology or systems issue results in any transaction being reported to a FINRA system outside of the price bands disseminated pursuant to the Plan, a FINRA officer, acting on his or her own motion or at the request of a member, shall review and deem any such trades as clearly erroneous, so long as the member certifies that the subject transaction(s) occurring outside of the applicable price bands disseminated pursuant to the Plan is the result of the member's bona fide technological or systems issue.<sup>8</sup>

Absent extraordinary circumstances, any action by a FINRA officer shall be taken in a timely fashion, generally within thirty (30) minutes of the detection of the erroneous transaction. When extraordinary circumstances exist, any such action of the FINRA officer must be taken by no later than the start of normal market hours on the trading day following the date on which the execution(s) under review occurred.

Although FINRA will act as promptly as possible and the proposed objective standard (i.e., whether an execution occurred outside the band) should make it feasible to quickly make a determination, FINRA may require additional time to obtain the required certification from a member that the transaction(s) outside of the price bands occurred as a result of the member's bona fide technological or systems issue. In addition, there may be circumstances in which additional time may be needed for verification of facts or coordination with outside parties, including the single plan processor responsible for disseminating the price bands and other SROs. Accordingly, FINRA believes it necessary to maintain some flexibility to make a determination outside of the thirty (30) minute guideline. In addition, FINRA proposes that a

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<sup>8</sup> During for cause reviews of clearly erroneous trades or examinations of member firms, FINRA will review whether there is sufficient documentation of technology or system issues to reasonably substantiate the certifications. FINRA also will review members' procedures for complying with the Limit Up-Limit Down Plan.

transaction that is deemed clearly erroneous pursuant to new Supplementary Material .03 would be appealable in accordance with the provisions of Rule 11894. In addition, FINRA proposes to make clear that, in the event that a single plan processor experiences a technology or systems problem that prevents the dissemination of price bands, FINRA would make the determination of whether to deem transactions clearly erroneous based on Rule 11892 paragraphs (a) and (b) and Supplementary Material .01.

FINRA believes that it is consistent with the purpose and intent of the Plan to deem as clearly erroneous transactions that occur otherwise than on an exchange and are reported to a FINRA system that occur outside of the price bands disseminated pursuant to the Plan as a result of a members technology or systems issue.

FINRA has filed the proposed rule change for immediate effectiveness. The effective date of the proposed rule change will be the date of filing.

## 2. Statutory Basis

FINRA believes that the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities association and, in particular, with the requirements of Section 15A of the Act.<sup>9</sup> In particular, the proposal is consistent with Section 15A(b)(6)<sup>10</sup> because it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect investors and the public interest.

FINRA believes that the pilot program promotes just and equitable principles of trade in that it promotes transparency and uniformity across SROs concerning reviews of transactions as clearly erroneous. More specifically, FINRA believes that the extension of the clearly erroneous

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<sup>9</sup> 15 U.S.C. 78o-3.

<sup>10</sup> 15 U.S.C. 78o-3(b)(6).

pilot would help assure that the determination of whether a clearly erroneous trade has occurred will be based on clear and objective criteria, and that the resolution of the incident will occur promptly through a transparent process. The proposed rule change also would help assure consistent results in handling erroneous trades across the U.S. markets, thus furthering fair and orderly markets, the protection of investors and the public interest. Although the Limit Up-Limit Down Plan will be operational during the same time period as the proposed extended clearly erroneous pilot, FINRA believes that maintaining the clearly erroneous pilot for at least through the phased implementation of the Plan will help to protect against unanticipated consequences. To that end, the extension will allow FINRA to determine whether Rule 11892 is necessary once the Plan is operational and, if so, whether improvements can be made.

Further, FINRA believes it is consistent with the protection of investors and the public interest to adopt objective criteria to deem transactions reported to a FINRA system outside of the price bands as clearly erroneous when a member has certified that such transaction was due to the member's bona fide systems or technology issue.

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

FINRA does not believe that the proposed rule change implicates any competitive issues. To the contrary, FINRA believes that the other SROs also are filing similar proposals and, thus, the proposal will help to ensure consistent rules across the marketplace.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

FINRA has not solicited, and does not intend to solicit, comments on this proposed rule change. FINRA has not received any written comments from members or other interested parties.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the proposed rule change does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>11</sup> and Rule 19b-4(f)(6)(iii) thereunder.<sup>12</sup>

FINRA has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest, as it will allow the pilot program to continue uninterrupted, thereby avoiding the investor confusion that could result from a temporary interruption in the pilot program. For this reason, the Commission designates the proposed rule change to be operative upon filing.<sup>13</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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<sup>11</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>12</sup> 17 CFR 240.19b-4(f)(6)(iii). As required under Rule 19b-4(f)(6)(iii), FINRA provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and the text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

<sup>13</sup> For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).



#### 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2013-012 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2013-012. This file number should be included on the subject line if e-mail 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 website (<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 website viewing and printing in the Commission's Public Reference Room on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal offices of FINRA. 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-FINRA-2013-012, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>14</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).