

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-64071; File No. SR-NASDAQ-2010-074)

March 11, 2011

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Amendment No. 3 to a Proposed Rule Change and Order Granting Accelerated Approval to the Proposed Rule Change, as Modified by Amendment Nos. 1 and 3, to Adopt Rule 4753(c) as a Six Month Pilot in 100 NASDAQ-Listed Securities

I. Introduction

On June 18, 2010, The NASDAQ Stock Market LLC (“Nasdaq” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to implement, on a six-month pilot basis, a volatility-based trading pause in 100 Nasdaq-listed securities (“Volatility Guard”). On June 25, 2010, Nasdaq filed Amendment No. 1 to the proposed rule change. The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on July 15, 2010.<sup>3</sup> The Commission received four comment letters on the proposal.<sup>4</sup> Nasdaq responded to these comments on August 12, 2010.<sup>5</sup> The Commission subsequently extended the time period in which to either approve the

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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> See Securities Exchange Act Release No. 62468 (July 7, 2010), 75 FR 41258.

<sup>4</sup> See Letter from Joe Ratterman, Chairman and Chief Executive Officer, BATS Global Markets, Inc., to Hon. Mary Schapiro, Chairman, Commission, dated July 1, 2010 (“BATS Letter”); Letter from Jose Marques, Managing Director, Deutsche Bank Securities Inc., to Elizabeth M. Murphy, Secretary, Commission, dated July 21, 2010 (“Deutsche Bank Letter”); Letter from Janet M. Kissane, Senior Vice President, Legal and Corporate Secretary, NYSE Euronext, to Elizabeth Murphy, Secretary, Commission, dated August 3, 2010 (“NYSE Letter”); Letter from Ann L. Vlcek, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, to Elizabeth M. Murphy, Secretary, Commission, dated June 25, 2010 (“SIFMA Letter”).

<sup>5</sup> See Letter from T. Sean Bennett, Assistant General Counsel, Nasdaq, to Elizabeth M. Murphy, Secretary, Commission (“Nasdaq response”).

proposed rule change, or to institute proceedings to determine whether to disapprove the proposed rule change, to October 13, 2010.<sup>6</sup> On October 13, 2010, the Commission instituted proceedings to determine whether to disapprove the proposed rule change.<sup>7</sup> The Commission thereafter received a fifth comment letter on the proposed rule change.<sup>8</sup> On January 10, 2011, the Commission extended the time period within which to either approve or disapprove the proposed rule change to March 11, 2011.<sup>9</sup> On March 10, 2011, the Exchange filed Amendment Nos. 2 and 3 to the proposed rule change.<sup>10</sup> The Commission is publishing this notice and order to solicit comments on Amendment No. 3 and to approve the proposed rule change, as modified by Amendment Nos. 1 and 3, on an accelerated basis.

## II. Description of the Proposal

Nasdaq proposed to adopt, on a pilot basis, a volatility-based trading halt for 100 Nasdaq-listed securities. Under this proposal, Nasdaq would suspend trading in a security if a trade in that security is executed at a price that exceeds a certain threshold, as measured over the preceding 30 seconds. The triggering threshold varies according to the price of the security, *i.e.*, 15% for securities with an execution price of \$1.75 and under; 10% for securities over \$1.75 and

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<sup>6</sup> See Securities Exchange Act Release No. 62740 (August 18, 2010), 75 FR 52049 (August 24, 2010).

<sup>7</sup> See Securities Exchange Act Release No. 63098 (October 13, 2010), 75 FR 64384 (October 19, 2010).

<sup>8</sup> See Letter from Timothy Quast, Managing Director, Modern IR LLC, to Elizabeth M. Murphy, Secretary, Commission, dated November 11, 2010 (“Modern IR Letter”).

<sup>9</sup> See Securities Exchange Act Release No. 63685, 76 FR 2732 (January 14, 2011).

<sup>10</sup> See Amendment No. 3 dated March 10, 2011 (“Amendment No. 3”). Amendment No. 3 replaces and supersedes Amendment No. 2. Amendment No. 3 extended the proposed start date of the pilot program from August 1, 2010 to a pilot period ending six months after the date of Commission approval of SR-NASDAQ-2010-074. The Exchange proposed to implement the rule change on a date to be announced to the public through a widely disseminated alert.

up to \$25; 5% for securities over \$25 and up to \$50; and 3% for securities over \$50. If the Volatility Guard were triggered, Nasdaq would suspend trading in that security for a period of 60 seconds, but would maintain all current quotes and orders during that time, and would continue to accept quotes and orders. Following this 60-second period, Nasdaq would re-open the market using its Halt Cross mechanism.<sup>11</sup> According to Nasdaq, the proposed Volatility Guard is similar in purpose to the Liquidity Replenishment Points (“LRPs”) rules that currently exist on the New York Stock Exchange (“NYSE”).<sup>12</sup>

### III. Comment Letters

The Commission received four comment letters opposing the proposed rule change<sup>13</sup> and one comment letter in favor of the proposed rule change.<sup>14</sup> Nasdaq responded to the comments regarding its proposal.<sup>15</sup>

Three of the four commenters opposing the proposal expressed concerns about its effect upon market volatility. These commenters stated that the Volatility Guard could actually increase volatility marketwide by re-directing trading in a security to other potentially less liquid venues once trading in that security had been halted on Nasdaq.<sup>16</sup> One commenter specifically argued that this proposal, coupled with the LRPs currently in effect on the NYSE, would result in disparate market approaches towards dampening volatility that may create confusion among

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<sup>11</sup> The Nasdaq Halt Cross is “the process for determining the price at which Eligible Interest shall be executed at the open of trading for a halted security and for executing that Eligible Interest.” See Nasdaq Rule 4753(a)(3).

<sup>12</sup> See NYSE Rule 1000(a)(iv).

<sup>13</sup> See BATS Letter ; Deutsche Bank Letter; SIFMA Letter; Modern IR Letter.

<sup>14</sup> See NYSE Letter.

<sup>15</sup> See Nasdaq response, supra note 5.

<sup>16</sup> See BATS Letter at 2; Deutsche Bank Letter at 4; SIFMA Letter at 3.

market participants, particularly in times of market stress, and exacerbate market volatility.<sup>17</sup>

Another commenter argued that the Volatility Guard would inappropriately impede the market's price-setting mechanism, to the detriment of issuers and investors.<sup>18</sup>

One commenter, however, supported Nasdaq's "right to design the controls it believes are best for trading on its market."<sup>19</sup> This commenter stated that the national market system was designed to encourage competitive distinctions such as Nasdaq's Volatility Guard and NYSE's LRPs.<sup>20</sup> According to this commenter, both the Nasdaq proposal and the NYSE LRPs "provide certainty and predictability of operation," and permit those markets to pursue strategies where the quality of price need not always defer to speed of execution.<sup>21</sup>

In its response, Nasdaq rejected the argument that the proposed Volatility Guard would exacerbate market volatility.<sup>22</sup> Nasdaq stated that it specifically designed the proposed Volatility Guard to work within the parameters of the single-stock circuit breaker pilot program currently in effect across all markets, and to avoid the potential for conflicting standards between the two mechanisms.<sup>23</sup> Nasdaq also asserted that there is no evidence that the proposed Volatility Guard would increase volatility in a particular security; rather, Nasdaq stated that the Volatility Guard would actually keep aberrant volatility on Nasdaq from spreading to other markets.<sup>24</sup>

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<sup>17</sup> See Deutsche Bank Letter at 4.

<sup>18</sup> See Modern IR Letter at 1-2.

<sup>19</sup> See NYSE Letter at 2. In its comment letter, NYSE also addressed what it perceived as Nasdaq's inaccurate description of the LRPs. NYSE provided additional detail about the LRPs, the role of the LRPs during the events of May 6, 2010, and the interaction between LRPs and the single-stock circuit breaker pilot program.

<sup>20</sup> Id.

<sup>21</sup> Id. at 3-4.

<sup>22</sup> See Nasdaq response, supra note 5, at 2.

<sup>23</sup> Id.

<sup>24</sup> Id.

Nasdaq also argued that the proposed Volatility Guard differed significantly from the NYSE LRPs, and that criticizing the Volatility Guard by comparing it to the LRPs was misleading. Nasdaq stated that the Volatility Guard, unlike the LRPs, would be based on clear and predictable criteria that would trigger a pause only in the event of a significant imbalance.<sup>25</sup> Accordingly, Nasdaq did not believe it appropriate to make a generic assertion that all market-based single-stock trading pauses are detrimental to the overall market.<sup>26</sup>

Finally, Nasdaq stated that it was proposing to employ prudent precautions in implementing the Volatility Guard. In particular, Nasdaq would implement the Volatility Guard as a pilot, limited in time and scope, during which time the Volatility Guard could be adjusted as needed. Nasdaq would also provide data to the Commission during the pilot period about the efficiency and effect of the Volatility Guard.<sup>27</sup>

#### IV. Discussion and Commission Findings

After carefully considering the proposal and the comments submitted, the Commission finds that the proposed rule change, as modified by Amendment Nos. 1 and 3, is consistent with the requirements of the Act and the rules and regulations thereunder.<sup>28</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>29</sup> which requires that the rules of an exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade,

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<sup>25</sup> Id. at 3.

<sup>26</sup> Id.

<sup>27</sup> Id.

<sup>28</sup> In approving this amendment, the Commission has considered the proposed amendment's impact of efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>29</sup> 15 U.S.C. 78f(b)(5).

to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

Nasdaq's proposal is presented by the Exchange as an effort to protect Nasdaq-listed securities and Nasdaq market participants from aberrant volatility, such as that witnessed on May 6, 2010. According to Nasdaq, the Volatility Guard is similar in purpose to the LRP rules that currently exist on the NYSE. A few commenters argued that individual exchange-specific mechanisms to moderate volatility may in fact exacerbate the volatility of the market overall, create confusion, and complicate the operation of the market-wide single stock circuit breakers.<sup>30</sup> However, the commenters opposing the proposal did not provide data or other evidence to support their contention. In addition, the Commission notes that the presence of another exchange-specific volatility moderator, the NYSE LRPs, was not found by the Report of the Staffs of the Commodity Futures Trading Commission and the Commission (the "May 6 Staff Report")<sup>31</sup> to have caused or created the broad-based liquidity crisis on that day.<sup>32</sup>

Since the events of May 6, 2010, the Commission has been working with the exchanges and FINRA on a consistent mechanism, applicable throughout the U.S. markets, to moderate excessive volatility in individual securities. On June 10, 2010, the Commission approved, on a pilot basis, circuit breaker rules that pause trading for five minutes in a security in the S&P 500

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<sup>30</sup> See notes 16-17 *supra* and accompanying text.

<sup>31</sup> See Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues, "Findings Regarding the Market Events of May 6, 2010", dated September 30, 2010.

<sup>32</sup> Id. at 70. The May 6 Staff Report did note, however, that the increasing number of LRPs being triggered on NYSE underscored the severity of market conditions as they were unfolding, and that this additional "evidence" played into market participants' decisions to reduce liquidity, pause trading, or withdraw from the markets. Id. at 70-71.

Index if its price moves ten percent or more over a five-minute period.<sup>33</sup> On September 10, 2010, the circuit breaker pilot was expanded to include securities in the Russell 1000 Index and certain exchange-traded products.<sup>34</sup> The Commission continues to work with the exchanges and FINRA to assess the operation of the circuit breaker pilot and its possible expansion, as well as the prospect of supplementing the circuit breakers with “limit up/limit down” style trading parameters.

In light of the fact that the circuit breaker mechanism in effect today applies only to certain securities, and that its operation currently is being evaluated under the pilot, and in recognition of the current existence of NYSE’s LRPs, the Commission believes there is continued room for experimentation with certain exchange-specific volatility moderators. Accordingly, the Commission today finds that Nasdaq’s proposal to implement the Volatility Guard for a six-month pilot program in 100 Nasdaq-listed securities is consistent with the Act.

The Commission emphasizes, however, that it is continuing to work diligently with the exchanges and FINRA to develop an appropriate consistent cross-market mechanism to moderate excessive volatility that could be applied widely to individual exchange-listed securities and to address commenters’ concerns regarding the complexity and potential confusion of exchange-specific volatility moderators. To the extent the Commission approves such a mechanism, whether it be an expanded circuit breaker with a limit up/limit down feature or otherwise, the Commission may no longer be able to find that exchange-specific volatility

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<sup>33</sup> See Securities Exchange Act Release Nos. 62251, 75 FR 34183 (June 16, 2010); 62252, 75 FR 34186 (June 16, 2010).

<sup>34</sup> See Securities Exchange Act Release Nos. 62883, 75 FR 56608 (September 16, 2010); 62884, 75 FR 56618 (September 16, 2010). The circuit breaker pilot currently is scheduled to end on April 11, 2011. See e.g., Securities Exchange Act Release Nos. 63497 (December 9, 2010), 75 FR 56618 (December 15, 2010); 63503 (December 9, 2010), 75 FR 78316 (December 15, 2010).

moderators – including both Nasdaq’s Volatility Guard and the NYSE’s LRPs – are consistent with the Act.

V. Accelerated Approval

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>35</sup> for approving the proposed rule change, as modified by Amendment Nos. 1 and 3 thereto, prior to the 30th day after the date of publication of Amendment No. 3 in the Federal Register. In Amendment No. 3, the Exchange proposed to change the start date of the pilot period from August 1, 2010 to a pilot period ending six months after the date of Commission approval of SR-NASDAQ-2010-074, because as originally proposed, the pilot period would have expired on February 1, 2011, which is prior to the Commission’s approval date. By granting accelerated approval, the pilot program may be implemented without delay. Accordingly, the Commission finds that good cause exists to approve the proposal, as modified by Amendment Nos. 1 and 3, on an accelerated basis.

VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 3 to 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-NASDAQ-2010-074 on the subject line.

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<sup>35</sup> 15 U.S.C. 78s(b)(2).



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-NASDAQ-2010-074. 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 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 the filing will also be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-NASDAQ-2010-074 and should be submitted on or before [insert date 21 days from date of publication in the Federal Register].

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>36</sup> that the proposed rule change (SR-NASDAQ-2010-074), as modified by Amendment Nos. 1 and 3, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>37</sup>

Cathy H. Ahn  
Deputy Secretary

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<sup>36</sup> 15 U.S.C. 78s(b)(2).

<sup>37</sup> 17 CFR 200.30-3(a)(12).