



DIVISION OF
TRADING AND MARKETS

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

July 20, 2016

Mr. T. Sean Bennett
Associate General Counsel
Nasdaq Stock Market LLC
805 King Farm Boulevard
Rockville, MD 20850

Re: Exemption Under Rule 608(e) of Regulation NMS under the Securities Exchange Act of 1934 from Certain Provisions of the “Plan to Implement a Tick Size Pilot Program”

Dear Mr. Bennett:

In its letter dated October 14, 2015,¹ the New York Stock Exchange LLC (“NYSE”), on behalf of itself and BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc. (“FINRA”), NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, the Nasdaq Stock Market LLC (“NASDAQ” or the “Exchange”), NYSE MKT LLC, and NYSE Arca, Inc. (collectively, “Participants”)² requested an exemption from certain quoting and trading requirements set forth in the Plan to Implement a Tick Size Pilot Program (“Tick Size Pilot Plan”).³ Specifically, in the October Exemption Request, the Participants requested that the Commission, pursuant to Rule 608(e) of Regulation NMS under the Securities Exchange Act of 1934 (“Exchange Act”), exempt the Participants from the requirements of Rule 608(c) of Regulation NMS that they comply, and enforce the compliance by their members with certain

¹ See letter from Elizabeth K. King, New York Stock Exchange, to Brent J. Fields, Secretary, Security and Exchange Commission (“Commission”) dated October 14, 2015 (“October Exemption Request”).

² The Commission notes that on February 5, 2016, the National Stock Exchange, Inc. (“NSX”) filed a Plan amendment with the Commission to become a Plan Participant pursuant to Section II.C of the Plan. See Securities Exchange Act Release No. 77277 (March 3, 2016), 81 FR 12162 (March 8, 2016).

³ See Securities Exchange Act Release No. 74892 (May 6, 2015), 80 FR 27513 (May 13, 2015).

provisions of Section VI of the Tick Size Pilot Plan when the Closing Price⁴ of a Pilot Security assigned to any Test Group is below \$1.00.

On February 23, 2016, FINRA, on behalf of itself and the Participants, submitted an additional request for exemption from certain quoting and trading provisions set forth in the Tick Size Pilot Plan.⁵ Specifically, the Participants requested that the Commission, pursuant to Rule 608(e) of Regulation NMS under the Exchange Act, exempt them from the requirements of Rule 608(c) of Regulation NMS that they comply, and enforce compliance by their members, with: (1) certain provisions of Section VI.C and Section VI.D of the Tick Size Pilot Plan to permit a member to execute certain orders in increments other than \$0.05 when a member has executed a proprietary trade in an increment other than \$0.05 that triggers the obligation to execute another customer order held by the member; (2) certain provisions of Section VI.D to permit members to execute certain error correction transactions in Test Group Three as an additional exception to the Trade-at Prohibition; and (3) Section VI.D(12) concerning the stopped order exception to the Trade-at Prohibition..

The Commission notes that NASDAQ submitted a proposed rule change to implement the quoting and trading requirements set forth in the Tick Size Pilot Plan and that the proposed rule change includes rules that address the items described herein for which NASDAQ seeks exemption from Rule 608(c) of Regulation NMS.⁶

Rule 608(c) of Regulation NMS requires the Participants to comply with the terms of the Tick Size Pilot Plan.⁷ Further, Rule 608(c) of Regulation NMS requires each Participant to enforce compliance with the Tick Size Pilot Plan by its members and persons associated with its members.⁸ Rule 608(e) of Regulation NMS provides that the Commission may exempt from the provisions of Rule 608 of Regulation NMS, either conditionally or on specified terms and conditions, any self-regulatory organization, if the Commission determines that such exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets, and the removal of impediments to, and the perfection of the mechanisms of, a national market system.⁹

As discussed below, the Commission, pursuant to its authority under Rule 608(e) of Regulation NMS, is hereby granting NASDAQ a limited exemption from the requirement to

⁴ Unless otherwise specified, capitalized terms in this rule filing are based on the defined terms of the Plan

⁵ See letter from Marcia E. Asquith, Senior Vice President and Corporate Secretary, FINRA, to Robert W. Errett, Deputy Secretary, Commission dated February 23, 2016 (“February Exemption Request”).

⁶ See Securities Exchange Act No. 78251 (July 7, 2016), 81 FR 45315 (July 13, 2016) (“NASDAQ Proposal”).

⁷ 17 CFR 242.608(c).

⁸ Id.

⁹ 17 CFR 242.608(e).

comply with certain provisions of the Tick Size Pilot Plan as required under Rule 608(c) of Regulation NMS.¹⁰

Exemption from Certain Provisions of the Tick Size Pilot Plan

I. **Exemption from the Requirement to Enforce Compliance with Certain Grouping, and Quoting and Trading Requirements for Pilot Securities Under Sections VI of the Tick Size Pilot Plan**

Section V of the Tick Size Pilot Plan sets forth the criteria for identifying Pilot Securities and the method by which Pilot Securities will be grouped and placed into the three Test Groups. Pursuant to Section V of the Tick Size Pilot Plan, Pilot Securities that are not placed into the three Test Groups will constitute the Control Group. Section VI of the Tick Size Pilot Plan sets forth the quoting and trading requirements established for the Control Group and each Test Group.

In the October Exemption Request, the Participants requested an exemption from Section VI of the Tick Size Pilot Plan to permit Participants to move a Pilot Security from its assigned Test Group to the Control Group if the Closing Price of a Pilot Security is below \$1.00 on any trading day during the Pilot Period.¹¹ A Pilot Security that is reassigned to the Control Group would be subject to the quoting and trading requirements of the Control Group. In addition, any reassigned Pilot Security would continue to be subject to the data collection provisions of the Tick Size Pilot Plan.

In the NASDAQ Proposal, NASDAQ Rule 4770(a)(5) provides, in pertinent part, that if a Pilot Security's Closing Price is below \$1.00, then that Pilot Security would be moved from its respective Test Group to the Control Group, and would quote and trade in accordance with the rules for Pilot Securities in the Control Group for the remainder of the Pilot Period.¹² In addition, such Pilot Security would continue to be subject to the data collection requirements under the Tick Size Pilot Plan and NASDAQ Rule 4770(b).

In the October Exemption Request, the Participants stated that requiring a Pilot Security whose price falls below \$1.00 to quote and/or trade in \$0.05 increments could be potentially

¹⁰ The Commission notes that while the October Exemption Request and the February Exemption Request seek exemptive relief for all of the Participants, the Commission is granting exemptive relief only to NASDAQ. The Commission would consider granting similar limited exemptions to other Participants should they submit proposed rule changes pursuant to Section 19(b) of the Exchange Act that are substantially similar to the NASDAQ Proposal.

¹¹ See October Exemption Request, supra note 1.

¹² NASDAQ Rule 4770(a)(5) also provides that if a Pilot Security's price drops below \$1.00 during regular trading hours but does not have a Closing Price below \$1.00 the Pilot Security will continue to trade according to the quoting and trading of its assigned Test Group.

harmful as the spread for such Pilot Security could become too large in comparison to its price. Further, the Participants believe that this could have a negative impact on the trading activity for such securities. Finally, the Participants believe that if such Pilot Securities are not moved into the Control Group, the quality of data generated and collected could be impacted because the spreads associated with such Pilot Securities would not correlate with their actual price.

The Commission grants the exemption to NASDAQ from the requirements in Section VI of the Tick Size Pilot Plan that Pilot Securities with a Closing Price below \$1.00 must quote and trade according to the provisions of its assigned Test Group, so long as NASDAQ complies, and enforces compliance by its member with, NASDAQ Rule 4770(a)(5). Accordingly, NASDAQ may move any Pilot Security that has a Closing Price below \$1.00 during the Pilot Period from a Tick Size Pilot Plan Test Group to the Control Group. Thereafter, such Pilot Security would be permitted to quote and trade according to the provisions of the Control Group for the remainder of the Pilot Period. Further, NASDAQ and its members must continue to collect and submit the data related to such Pilot Security as set forth in the Tick Size Pilot Plan and NASDAQ Rule 4770(b).

The Commission has determined that this exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and the perfection of a national market system, because requiring Pilot Securities with a Closing Price of less than \$1.00 to quote and/or trade in increments larger than as provided under the Control Group could cause the spread for such Pilot Securities to become too large relative to its price, which could potentially harm the trading of such securities and the quality of the data generated under the Tick Size Pilot Plan.

II. Exemption from the Requirement to Enforce Compliance with Certain Trading Requirements Under Sections VI.C and VI.D of the Tick Size Pilot Plan

Section VI.C of the Tick Size Pilot Plan sets forth the quoting and trading requirements for Pilot Securities in Test Group Two. Specifically, Test Group Two Pilot Securities may only be quoted and traded in \$0.05 increments, subject to the following circumstances:¹³ (i) trading may occur at the midpoint between the National Best Bid and National Best offer (“NBBO”) or the midpoint between the best protected bid and best protected offer (“PBBO”); (ii) Retail Investor Orders may be provided price improvement of at least \$0.005 better than the PBBO; and (iii) Negotiated Trades may trade in increments less than \$0.05. NASDAQ proposes to implement these provisions in NASDAQ Rule 4770(c)(2)(C)(i), (ii), and (iii).¹⁴

Section VI.D of the Tick Size Pilot Plan sets forth the quoting and trading requirements for Pilot Securities in Test Group Three. Specifically, Test Group Three Pilot Securities may only be quoted and traded in \$0.05 increments, subject to the same three trading circumstances noted above for Test Group Two,¹⁵ and are subject to the Trade-at Prohibition. NASDAQ

¹³ Section VI.C of the Tick Size Pilot Plan also provides certain quoting exceptions.

¹⁴ See NASDAQ Proposal, supra note 6.

¹⁵ Section VI.D of the Tick Size Pilot Plan also provides certain quoting exceptions.

proposes to implement these provisions in NASDAQ Rule 4770(c)(3)(C)(i), (ii), and (iii) along with NASDAQ Rule 4770(c)(3)(C).¹⁶

In the February Exemption Request, the Participants noted that a member of a Participant may be obligated under its rules (e.g., NASDAQ Rule 5320A) to execute a customer order in a Pilot Security after executing a proprietary trade in the same Pilot Security. In these instances, the Participants requested that members be exempt from having to execute such a customer order in a Test Group Two Pilot Security or a Test Group Three Pilot Security in a \$0.05 increment. Rather, the Participants propose to allow its members in these instances to execute the customer order at the same price as (or within the prescribed amount of), for the same Pilot Security, on the same side as the triggering proprietary trade.

In the NASDAQ Proposal, NASDAQ Rule 4770(c)(2)(C)(iv) would provide an exception in Test Group Two to the requirement of executing an order in a \$0.05 increment for the execution of customer orders to comply with NASDAQ Rule 5320A following the execution of a proprietary trade by the member at an increment other than \$0.05, where such proprietary trade was permissible pursuant to an exception under the Tick Size Pilot Plan. NASDAQ Rule 4770(c)(3)(C)(iv) would provide for the same exception for Test Group Three.

In the February Exemption Request, the Participants note that they believe that an additional exception to the requirement of executing orders in a \$0.05 trading increment in Test Group Two and Test Group Three would best facilitate the ability of members to continue to protect a customer order while retaining the flexibility to engage in proprietary trades that are permissible under the Tick Size Pilot Plan.

The Commission grants the exemption to NASDAQ from the \$0.05 increment trading requirements of Sections VI.C and VI.D for certain transactions so long as NASDAQ complies with, and enforces compliance with NASDAQ Rule 4770(c)(2)(C) and Rule 4770(c)(3)(C). The Commission has determined that this exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and the perfection of a national market system because it will facilitate the execution of customer orders.

III. Exemption from the Requirement to Enforce Compliance with Certain Trading Requirements Under Section VI.D of the Tick Size Pilot Plan for Error Correction Transactions

As noted above, Section VI.D of the Tick Size Pilot Plan sets forth the quoting and trading requirements for Pilot Securities in Test Group Three, which includes the Trade-at Prohibition. In the February Exemption Request, the Participants requested an exemption from having to comply, and enforce compliance by its members with, the Trade-at Prohibition for certain error correction transactions. Rather, as set forth in NASDAQ Rule 4770(c)(3)(D)(iii)(o), certain error correction transactions as defined in NASDAQ Rule 4770(c)(3)(D)(iii)(o) would be exempted from the Trade-at Prohibition. In addition, NASDAQ notes in its proposal that

¹⁶ See NASDAQ Proposal, supra note 6.

NASDAQ Rule 4770(c)(3)(D)(iii)(o) would be subject to conditions set forth in the Commission's Order exempting error correction transactions from Rule 611 of Regulation NMS.¹⁷

The Participants note that certain error correction transactions are exempt from the provisions of Rule 611 of Regulation NMS. Accordingly, the Participants believe that certain transactions to correct bona fide errors in the execution of customer orders should likewise be exempted from the Trade-at Prohibition.

The Commission grants the exemption to NASDAQ from the requirements of Section VI.D of the Tick Size Pilot Plan so that certain error correction transactions would be exempted from the Trade-at Prohibition, so long as NASDAQ complies with and enforces compliance with NASDAQ Rule 4770(c)(3)(D)(iii)(o). The Commission has determined that this exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and the perfection of a national market system because it would provide consistency in how error correction transactions are treated. NASDAQ has proposed to use the same definition and process for error correction transactions under the Tick Size Pilot Plan as it does under Rule 611 of Regulation NMS.

IV. Exemption from the Requirement to Enforce Compliance with Certain Trading Requirements Under Section VI.D of the Tick Size Pilot Plan for "Stopped Orders"

Section VI.D(12) of the Tick Size Pilot Plan provides an exception to the Trade-at Prohibition for "stopped orders" that provides, among other things, that "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."

NASDAQ proposes to adopt a modified stopped order exception in NASDAQ Rule 4770(c)(3)(D)(iii)(m). Specifically, NASDAQ proposes NASDAQ Rule 4770(c)(3)(D)(iii)(m) to provide that "[t]he price of the Trade-at transaction was, for a stopped buy order, equal to or less than the National Best Bid in the Pilot Security at the time of execution or, for a stopped sell

¹⁷ See NASDAQ Proposal, *supra* note 6. See also Securities Exchange Act Release No. 55884 (June 8, 2007, 72 FR 32926 (June 14, 2007) (order exempting certain error correction transactions from Rule 611 of Regulation NMS). Specifically, the bona fide error must be evidenced by objective facts and circumstances. The Trading Center must maintain documentation of such facts and circumstances. The Trading Center must record the transaction in its error account. Further, 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. Finally, the Trading Center must regularly surveil to ascertain the effectiveness of its policies and procedures to address errors and transactions to correct errors and take prompt action to remedy deficiencies in such policies and procedures.

order, equal to or greater than the Nation Best Offer in the Pilot Security at the time of execution, as long as such order is priced at an acceptable increment.”

According to the Participants, the stopped order exception to the Trade-at Prohibition is based upon the exception provided for stopped orders in Rule 611 of Regulation NMS.¹⁸ However, as currently drafted, the Trade-at Prohibition exception for stopped orders would result in an inconsistent result compared to the analogous exception to Rule 611 of Regulation NMS. Accordingly, the Participants believe that the proposed stopped order exception to the Trade-at Prohibition would result in a more consistent approach for stopped orders.

The Commission grants the exemption to NASDAQ from the requirements of Section VI.D(12)(c) so long as NASDAQ complies with, and enforces compliance with NASDAQ Rule 4770(c)(3)(D)(iii)(m). The Commission has determined that this exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and the perfection of a national market system, because it would provide consistency in the treatment of stopped order transactions under both Regulation NMS and the Tick Size Pilot Plan. Therefore, the exemption should facilitate and ease implementation of the stopped order exception to the Trade-at Prohibition.

* * *

This exemption is conditioned on the facts and representations presented in your letter. In the event any material change occurs with respect to any of the facts or representations presented, the exemption will expire and the Exchange must immediately resume operating in accordance with all of the provisions in the Tick Size Pilot Plan.

For the Commission,
by the Division of Trading and Markets,
pursuant to delegated authority.¹⁹



David S. Shillman
Associate Director

¹⁸ Rule 611(b)(9)(iii) of Regulation NMS provides that “the 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.”

¹⁹ 17 CFR 200.30-3(a)(42).