

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-72961; File No. SR-NASDAQ-2014-081)

September 3, 2014

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change Relating to Proposed Changes to NASDAQ Rule 4120(c) to Modify the Parameters for Releasing Securities for Trading Upon the Termination of a Trading Halt in a Security that Is the Subject of an Initial Public Offering

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 August 20, 2014, The NASDAQ Stock Market LLC (“NASDAQ” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in in Items I, II, and III below, which Items have been prepared by NASDAQ. 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

NASDAQ proposes to amend NASDAQ Rule 4120(c) to modify the parameters for releasing securities for trading upon the termination of a trading halt in a security that is the subject of an initial public offering.

The text of the proposed rule change is available at <http://nasdaq.cchwallstreet.com/>, at NASDAQ’s principal office, 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, NASDAQ included statements concerning the purpose of, and basis for, the proposed rule change. The text of these statements may be examined at the

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

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

places specified in Item IV below. NASDAQ 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

The Exchange proposes to amend Rule 4120(c) to strengthen safeguards against unexpected volatility with respect to the price established by the NASDAQ Halt Cross for a security that is the subject of an IPO (the “IPO Halt Cross” or the “Cross”). In 2013, NASDAQ adopted a new process for releasing IPO securities.<sup>3</sup> The changes were adopted to improve the IPO release process by increasing NASDAQ’s flexibility to commence trading when appropriate. To this end, NASDAQ eliminated the former rule requirement that limited the number of extensions of the period prior to launch – the Display Only Period – to six five-minute periods. NASDAQ instead adopted a two-phase process under which the initial 15-minute Display Only Period is followed by a “Pre-Launch Period” that is not of a fixed duration. Under the current rule, the Pre-Launch Period will continue until (1) NASDAQ receives notice from the underwriter of the IPO that the security is ready to trade and there is no “order imbalance” in the security, in which case the security is released for trading; or (2) the underwriter, with concurrence of NASDAQ, determines to postpone and reschedule the IPO. Every five seconds during the Display Only Period and the Pre-Launch Period, NASDAQ disseminates the Current Reference Price, an indication of the price at which the IPO Halt Cross would execute if it occurred at that time.

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<sup>3</sup> Securities Exchange Act Release No. 69897 (July 1, 2013), 78 FR 40782 (July 8, 2013) (SR-NASDAQ-2013-092). See also Securities Exchange Act Release No. 70911 (November 21, 2013), 78 FR 71011 (November 27, 2013) (SR-NASDAQ-2013-143) (adopting additional refinements to process for IPO securities).

The requirement regarding the absence of an order imbalance was designed to ensure that the expected price of the security is reasonably stable and that trading interest is balanced at the time trading commences. There are currently several conditions under which an order imbalance in an IPO security will be considered to exist:

- the Current Reference Price disseminated immediately prior to commencing the release of the IPO for trading during the Pre-Launch Period and any of the three preceding Current Reference Prices differ by more than the greater of 5 percent or 50 cents;
- upon completion of the Cross calculation, the calculated price at which the security would be released for trading and any of the three preceding Current Reference Prices disseminated immediately prior to the initiation of the Cross calculation differ by more than the greater of 5 percent or 50 cents; or
- all market orders will not be executed in the Cross.

These restrictions are designed to prevent circumstances where a misunderstanding by the underwriter as to the state of the order book risks launching trading at a time of material volatility in the book for the security. Order imbalances are calculated by the IPO Halt Cross system, which automatically prevents launch of a halted security when an order imbalance exists.

NASDAQ is proposing to enable the underwriter to provide even greater protection against volatility in an IPO security by replacing the current system for comparing against prior Current Reference Prices with a system under which the expected price of the IPO Halt Cross will be displayed to the underwriter, who will then select price bands to ensure that the actual calculated price at which the IPO Halt Cross would occur does not deviate from the expected price by more than the selected amounts. Such price deviations are possible because market participants may continue to enter and cancel orders during the period between the display of the

expected price to the underwriter and the commencement of the Cross calculation, a period of up to five seconds in duration.<sup>4</sup> Although the current system has generally done a good job of protecting against unexpected changes in the pricing of an IPO Halt Cross by ensuring that the Current Reference Price has been stable and the final calculated price is not significantly different from preceding Current Reference Prices, the proposed change would introduce the opportunity for underwriters to set tighter limits at their discretion based on the characteristics of and expectations for each IPO.

Under the proposed modified system, the Pre-Launch Period will end and the security will be released for trading when the following conditions are all met:

- NASDAQ receives notice from the underwriter of the IPO that the security is ready to trade. The NASDAQ system will calculate the Current Reference Price at that time (the “Expected Price”) and display it to the underwriter. If the underwriter then approves proceeding, the NASDAQ system will conduct the following validation checks:
  - The NASDAQ system must determine that all market orders will be executed in the cross;<sup>5</sup>
  - the security passes a new price validation test, which will replace the current system for comparison against recent Current Reference Prices.

For purposes of applying the price validation test, the underwriter must select price bands

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<sup>4</sup> Cancellations received following the commencement of the Cross calculation are blocked, and orders received thereafter are not Cross-eligible. See In the Matter of The NASDAQ Stock Market LLC and NASDAQ Execution Services, LLC, Securities Exchange Act Release No. 69655 (May 29, 2013), at ¶65.

<sup>5</sup> This requirement is not being modified from the requirement of the current rule with respect to market orders, but the wording is being modified to make it clearer. The intent of the restriction is to ensure that if a market participant enters an order offering to buy or sell in the IPO Halt Cross at any price, the Cross should not occur unless all such orders can be executed.

prior to the conclusion of the Pre-Launch Period.<sup>6</sup> The System will then compare the Expected Price with the actual price calculated by the Cross. If the actual price calculated by the Cross differs from the Expected Price by an amount in excess of the price band selected by the underwriter, the security will not be released for trading and the Pre-Launch Period will continue. The underwriter must select an upper price band (i.e., an amount by which the actual price may not exceed the Expected Price) and a lower price band (i.e., an amount by which the actual price may not be lower than the Expected Price). If a security does not pass the price validation test, the underwriter may, but is not required to, select different price bands before recommencing the process to release the security for trading.

For example, assume that the Expected Price for the IPO Halt Cross shown to the underwriter was \$32 per share, and the underwriter selected an upper price band of \$0.10 and a lower price band of \$0.05. In that case, the actual price calculated by the system for the Cross could not be higher than \$32.10 nor lower than \$31.95.

As is currently the case, the failure to satisfy any of the conditions for completion of the IPO Cross results in a delay of the release for trading of the IPO, and a continuation of the Pre-Launch Period, until all conditions have been satisfied. Thus, if the price validation is not satisfied, the Pre-Launch Period would continue seamlessly, with members able to continue to enter or cancel orders. The security would then repeat the process for release until such time as the conditions required for launch were satisfied. Thus, the underwriter would again have to determine that it believes the security is ready to trade, the underwriter would be shown the applicable Expected Price, and the security would launch if all market orders would be executed

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<sup>6</sup> The underwriter can select the price bands at any time during the Display Only Period or Pre-Launch Period, and can modify them at any time prior to the conclusion of the Pre-Launch Period.

and the price validation was satisfied. As noted above, the underwriter would be able to select different price bands for each attempt to launch the security. Thus, an underwriter might select an upper and a lower band of \$0 initially, such that the security would not launch unless the calculated price equaled the Expected Price. If the security did not pass the validation check, however, the underwriter could subsequently choose to widen the price bands to allow the IPO to proceed at a price that might vary from the Expected Price. As is also currently the case, the underwriter, with concurrence of NASDAQ, may determine at any point during the IPO Halt Cross process up through the conclusion of the Pre-Launch Period to postpone and reschedule the IPO.<sup>7</sup>

The price bands available for selection shall be in such increments, and at such price points, as may be established from time to time by NASDAQ. The initial available price bands will range from \$0 to \$0.50, with increments of \$0.01. Thus, the underwriter may select a price band of \$0 (i.e., no change from the Expected Price is permitted), \$0.01, \$0.02, or any other \$0.01 increment up to \$0.50. The underwriter may select different price bands above and below the Expected Price. NASDAQ reserves the right to stipulate wider increments (such as \$0.05) or price bands that include certain price points but exclude others (for example, increments of \$0.01 up to \$0.10, and increments of \$0.05 thereafter). In selecting available price bands and increments, NASDAQ will consider input from underwriters and other market participants and the results of past usage of price bands to adopt price bands and increments that promote efficiency in the initiation of trading and protect investors and the public interest. NASDAQ will notify member organizations and the public of changes in available price band or increments through a notice that is widely disseminated at least one week in advance of the change.

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<sup>7</sup> NASDAQ is modifying the applicable language slightly to make it clear that the authority to cancel and reschedule extends to the conclusion of the Pre-Launch Period.

However, NASDAQ will not (in the absence of the submission of a proposed rule change) allow bands wider than \$0.50. Thus, bands will not be wider than the bands that currently govern the comparison between the Cross price and previous Current Reference Prices.

In addition to the foregoing changes, NASDAQ is also proposing to reorganize provisions of Rule 4120 relating to the process for ending a trading halt of securities other than IPO securities. NASDAQ is not making substantive modifications to these rules, however.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>8</sup> in general, and with Section 6(b)(5) of the Act,<sup>9</sup> in particular, in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transaction in securities, 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. The proposed rule change promotes these goals by strengthening protection against unexpected volatility in the pricing of an IPO security. While the current rule provides protection against volatility by providing that the final price of an IPO security calculated by the IPO Halt Cross may not deviate from the most recent three indicative prices by more than five percent or \$0.50, there nevertheless exists the possibility that deviations within these bands will occur. The proposed change is designed to protect the underwriter and other market participants from the IPO Halt Cross occurring at a price that deviates unexpectedly from the prices previously disclosed through the Current Reference Price by providing the underwriter the authority to set tighter limits based on the characteristics of and expectations for each IPO.

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<sup>8</sup> 15 U.S.C. 78f.

<sup>9</sup> 15 U.S.C. 78f(b)(5).

NASDAQ believes that enhancing and strengthening the process in this manner will protect investors as it will serve to minimize unexpected price deviations and avoid confusion among market participants.

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

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. Specifically, the change will not affect the ability of market participants to participate fully in the IPO Halt Crosses. Rather, the change is designed to promote stability and reduce volatility in the pricing of the IPO Halt Cross, and therefore does not impose any restriction on competition.

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

Written comments were neither solicited nor received.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

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-NASDAQ-2014-081 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NASDAQ-2014-081. 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, 100 F Street, NE, Washington, DC 20549, 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 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 Number SR-NASDAQ-2014-081, 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>10</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).