

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66963; File No. SR-NYSEArca-2012-22)

May 10, 2012

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Approving a Proposed Rule Change to Amend NYSE Arca Equities Rule 7.45 to Address the Authority of NYSE Arca or Archipelago Securities LLC to Cancel Orders When a Technical or Systems Issue Occurs and Describe the Operation of an Error Account for Archipelago Securities

I. Introduction

On March 15, 2012, NYSE Arca, Inc. (“Exchange” or “NYSE Arca”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend NYSE Arca Equities Rule 7.45 to address the authority of NYSE Arca or Archipelago Securities LLC (“Arca Securities”) to cancel orders when a technical or systems issue occurs at NYSE Arca, Arca Securities, or a routing destination, and to describe the operation of an error account for Arca Securities. The proposed rule change was published for comment in the Federal Register on March 30, 2012.³ The Commission received no comment letters regarding the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposal

Arca Securities is a broker-dealer that is a facility, and an affiliate, of the Exchange that provides outbound routing services from the Exchange to other market centers pursuant to

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 66656 (March 26, 2012), 77 FR 19401 (March 30, 2012) (SR-NYSEArca-2012-22) (“Notice”).

Exchange rules.⁴ In its proposal, the Exchange states that a technical or systems issue may occur at NYSE Arca, Arca Securities, or a routing destination that causes NYSE Arca or Arca Securities to cancel orders, if the Exchange or Arca Securities determines that such action is necessary to maintain a fair and orderly market.⁵ The Exchange also states that a technical or systems issue that occurs at NYSE Arca, Arca Securities, a routing destination, or a non-affiliate third-party Routing Broker⁶ may result in Arca Securities acquiring an error position that it must resolve.⁷

New paragraph (d) to NYSE Arca Equities Rule 7.45 provides NYSE Arca and Arca Securities with general authority to cancel orders to maintain fair and orderly markets when a technical or systems issue occurs at NYSE Arca, Arca Securities, or a routing destination. It also provides authority for Arca Securities to maintain an error account for the purpose of addressing, and sets forth the procedures for resolving, error positions. Specifically, paragraph (d)(1) of

⁴ See Notice, 77 FR at 19402, n.4 and accompanying text, and text accompanying n.5. See also NYSE Arca Equities Rule 7.45; and Securities Exchange Act Release No. 65455 (September 30, 2011) 76 FR 62119 (October 6, 2011) (SR-NYSEArca-2011-61) at n.4.

The Exchange also receives equities orders routed inbound to the Exchange by Arca Securities from the New York Stock Exchange LLC and NYSE Amex LLC. See Notice, 77 FR at 19402, n.5. See also NYSE Arca Equities Rule 7.45(c).

⁵ See Notice, 77 FR at 19402. For examples of some of the circumstances in which NYSE Arca or Arca Securities may decide to cancel orders, see *id.*

⁶ The Exchange states that, from time to time, it also uses non-affiliate third-party broker-dealers to provide outbound routing services. See Notice, 77 FR at 19402, n.4. See also NYSE Arca Equities Rule 7.45(a) (defining “Routing Broker” to include Arca Securities and any other non-affiliate third-party broker-dealer that acts as a facility of NYSE Arca routing orders from the Exchange to other market centers).

⁷ See Notice, 77 FR at 19402. Specifically, the proposed rule defines “error positions” as “positions that result from a technical or systems issue at Arca Securities, the Exchange, a routing destination, or a non-affiliate third-party Routing Broker that affects one or more orders.” See proposed Rule 7.45(d)(2).

For examples of some of the circumstances that may lead to error positions, see Notice, 77 FR at 19402–03.

NYSE Arca Equities Rule 7.45 authorizes NYSE Arca or Arca Securities to cancel orders as either deems necessary to maintain fair and orderly markets if a technical or systems issue occurs at NYSE Arca, Arca Securities, or a routing destination. NYSE Arca and Arca Securities will be required to provide notice of the cancelation to all Electronic Trading Permit Holders (“ETP Holders”) as soon as practicable.⁸

Paragraph (d)(2) of NYSE Arca Equities Rule 7.45 will allow Arca Securities to maintain an error account for the purpose of addressing error positions that result from a technical or systems issue at NYSE Arca, Arca Securities, a routing destination, or a non-affiliate third-party Routing Broker.

For purposes of NYSE Arca Equities Rule 7.45(d), an error position will not include any position that results from an order submitted by an ETP Holder to NYSE Arca that is executed on the Exchange and processed pursuant to NYSE Arca Equities Rule 7.41(a).⁹ Arca Securities will not be permitted to (i) accept any positions in its error account from an ETP Holder’s account or (ii) permit any ETP Holder to transfer any positions from the ETP Holder’s account to Arca Securities’ error account.¹⁰ In other words, Arca Securities may not accept from an ETP Holder positions that are delivered to the ETP Holder through the clearance and settlement process, even if those positions may have been related to a technical or systems issue at NYSE Arca, Arca Securities, a routing destination, or a non-affiliate third-party Routing Broker.¹¹ If an

⁸ See NYSE Arca Equities Rule 7.45(d)(1).

⁹ See NYSE Arca Equities Rule 7.45(d)(2)(A).

¹⁰ See NYSE Arca Equities Rule 7.45(d)(2)(B).

¹¹ See Notice, 77 FR at 19403, n.13. This provision would not apply if Arca Securities incurred a short position to settle an ETP Holder’s purchase, as the ETP Holder would not have had a position in its account as a result of the purchase at the time of Arca Securities’ action. See id.

ETP Holder receives such positions through the clearance and settlement process and experiences a loss in unwinding those positions, that ETP Holder may seek to rely on NYSE Arca Equities Rule 13.2, which provides ETP Holders with the ability to file claims against the Exchange “for the failure of its systems or facilities.”¹² If, however, a technical or systems issue results in NYSE Arca not having valid clearing instructions for an ETP Holder to a trade, Arca Securities may assume that ETP Holder’s side of the trade so that the trade can be processed pursuant to NYSE Arca Equities Rule 7.41(a).¹³

Paragraph (d)(3) of NYSE Arca Equities Rule 7.45 permits NYSE Arca or Arca Securities, in connection with a particular technical or systems issue, to either (i) assign all resulting error positions to ETP Holders or (ii) have all resulting error positions liquidated. Any determination to assign or liquidate error positions, as well as any resulting assignments, will be made in a nondiscriminatory fashion.¹⁴

NYSE Arca and Arca Securities will be required to assign all error positions resulting from a particular technical or systems issue to the ETP Holders affected by that technical or systems issue if NYSE Arca or Arca Securities:

If error positions result in connection with the Exchange’s use of a third-party broker-dealer for outbound routing and those positions are delivered to Arca Securities through the clearance and settlement process, Arca Securities would be permitted to resolve those positions. If, however, such positions were not delivered to Arca Securities through the clearance and settlement process, then the third-party broker-dealer would resolve the error positions itself, and Arca Securities would not be permitted to accept the positions. See Notice, 77 FR at 19402, n.4.

¹² See Notice, 77 FR at 19403, n.13.

¹³ See NYSE Arca Equities Rule 7.45(d)(2)(C).

¹⁴ See NYSE Arca Equities Rule 7.45(d)(3).

- (i) Determines that it has accurate and sufficient information (including valid clearing information) to assign the positions to all of the ETP Holders affected by that technical or systems issue;
- (ii) Determines that it has sufficient time pursuant to normal clearance and settlement deadlines to evaluate the information necessary to assign the positions to all of the ETP Holders affected by that technical or systems issue; and
- (iii) Has not determined to cancel all orders affected by that technical or systems issue in accordance with NYSE Arca Equities Rule 7.45(d)(1).¹⁵

If NYSE Arca or Arca Securities is unable to assign all error positions resulting from a particular technical or systems issue to all of the affected ETP Holders, or if NYSE Arca or Arca Securities determines to cancel all orders affected by the technical or systems issue, then Arca Securities will be required to liquidate the error positions as soon as practicable.¹⁶ Arca Securities will be required to provide complete time and price discretion for the trading to liquidate the error positions to a third-party broker-dealer, and would be prohibited from attempting to exercise any influence or control over the timing or methods of such trading.¹⁷ Further, Arca Securities will be required to establish and enforce policies and procedures that are reasonably designed to restrict the flow of confidential and proprietary information between the third-party broker-dealer, on one hand, and the Exchange and Arca Securities on the other, associated with the liquidation of the error positions.¹⁸

¹⁵ See NYSE Arca Equities Rule 7.45(d)(3)(A)(i)–(iii).

¹⁶ See NYSE Arca Equities Rule 7.45(d)(3)(B).

¹⁷ See NYSE Arca Equities Rule 7.45(d)(3)(B)(i).

¹⁸ See NYSE Arca Equities Rule 7.45(d)(3)(B)(ii).

Finally, proposed paragraph (d)(4) of NYSE Arca Equities Rule 7.45 requires NYSE Arca and Arca Securities to make and keep records to document all determinations to treat positions as error positions; all determinations to assign error positions to ETP Holders or liquidate error positions; and the liquidation of error positions through the third-party broker-dealer.

III. Discussion and Commission's Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b) of the Act¹⁹ and the rules and regulations thereunder applicable to a national securities exchange.²⁰ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,²¹ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, 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 transactions 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; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. In addition, the Commission believes the proposed rule change is consistent with Section 11A(a)(1)(C) of the Act²² in that it seeks to assure economically efficient execution of securities transactions.

¹⁹ 15 U.S.C. 78f(b).

²⁰ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²¹ 15 U.S.C. 78f(b)(5).

²² 15 U.S.C. 78k-1(a)(1)(C).

The Commission recognizes that technical or systems issues may occur, and believes that NYSE Arca Equities Rule 7.45, in allowing NYSE Arca or Arca Securities to cancel orders affected by technical or systems issues, should provide a reasonably efficient means for the Exchange to handle such orders, and appears reasonably designed to permit NYSE Arca to maintain fair and orderly markets.²³

The Commission also believes that allowing the Exchange to resolve error positions through the use of an error account maintained by Arca Securities pursuant to the procedures set forth in the rule, and as described above, is consistent with the Act. The Commission notes that the rule establishes criteria for determining which positions are error positions,²⁴ and that NYSE Arca or Arca Securities, in connection with a particular technical or systems issue, will be required to either (i) assign all resulting error positions to ETP Holders or (ii) have all resulting error positions liquidated.²⁵ Also, NYSE Arca or Arca Securities will assign error positions that result from a particular technical or systems issue to ETP Holders only if all such error positions can be assigned to all of the ETP Holders affected by that technical or systems issue.²⁶ If NYSE Arca or Arca Securities cannot assign all error positions to all ETP Holders, Arca Securities will liquidate all of those error positions.²⁷ In this regard, the Commission believes that the new rule

²³ The Commission notes that NYSE Arca states that the proposed amendments to NYSE Arca Equities Rule 7.45 are designed to maintain fair and orderly markets, ensure full trade certainty for market participants, and avoid disrupting the clearance and settlement process. See Notice, 77 FR at 19404. The Commission also notes that NYSE Arca states that a decision to cancel orders due to a technical or systems issue is not equivalent to the Exchange declaring self-help against a routing destination pursuant to Rule 611 of Regulation NMS. See 17 CFR 242.611(b). See also Notice, 77 FR at 19403, n.11.

²⁴ See NYSE Arca Equities Rule 7.45(d)(2).

²⁵ See NYSE Arca Equities Rule 7.45(d)(3).

²⁶ See NYSE Arca Equities Rule 7.45(d)(3)(A).

²⁷ See NYSE Arca Equities Rule 7.45(d)(3)(B).

appears reasonably designed to further just and equitable principles of trade and the protection of investors and the public interest, and to help prevent unfair discrimination, in that it should help assure the handling of error positions will be based on clear and objective criteria, and that the resolution of those positions will occur promptly through a transparent process.

Additionally, the Commission notes that it has previously expressed concern about the potential for unfair competition and conflicts of interest between an exchange's self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members.²⁸ The Commission is also concerned about the potential for misuse of confidential and proprietary information. The Commission believes that the requirement that Arca Securities provide complete time and price discretion for the liquidation of error positions to a third-party broker-dealer, including that Arca Securities not attempt to exercise any influence or control over the timing or methods of such trading, combined with the requirement that the Exchange establish and enforce policies and procedures that are reasonably designed to restrict the flow of confidential and proprietary information to the third-party routing broker liquidating such positions, should help mitigate the Commission's concerns. In particular, the Commission believes that these requirements should help assure that none of the Exchange, Arca Securities, or the third-party broker-dealer is able to misuse confidential or proprietary information obtained in connection with the liquidation of error positions for its own benefit.

Finally, the Commission notes that NYSE Arca and Arca Securities would be required to make and keep records to document all determinations to treat positions as error positions; all

²⁸ See, e.g., Securities Exchange Act Release No. 65455, 76 FR at 62120, n.16 and accompanying text.

determinations to assign error positions to ETP Holders or liquidate error positions; and the liquidation of error positions through the third-party broker-dealer.²⁹

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³⁰ that the proposed rule change (SR-NYSEArca-2012-22) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³¹

Kevin M. O'Neill
Deputy Secretary

²⁹ See NYSE Arca Equities Rule 7.45(d)(4).

³⁰ 15 U.S.C. 78s(b)(2).

³¹ 17 CFR 200.30-3(a)(12).