

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-72434; File No. SR-BATS-2014-014; SR-BX-2014-021; SR-BYX-2014-007; SR-CHX-2014-06; SR-EDGA-2014-11; SR-EDGX-2014-12; SR-FINRA-2014-021; SR-ISE-2014-25; SR-NASDAQ-2014-044; SR-NSX-2014-08; SR-NYSE-2014-22; SR-NYSEArca-2014-48; SR-NYSEMKT-2014-37; SR-Phlx-2014-27)

June 19, 2014

Self-Regulatory Organizations; BATS Exchange, Inc.; BATS-Y Exchange, Inc.; NASDAQ OMX BX, Inc.; Chicago Stock Exchange, Inc.; EDGA Exchange, Inc.; EDGX Exchange, Inc.; Financial Industry Regulatory Authority, Inc.; International Securities Exchange LLC; The NASDAQ Stock Market LLC; National Stock Exchange, Inc.; New York Stock Exchange LLC; NYSE Arca, Inc.; NYSE MKT LLC; NASDAQ OMX PHLX LLC; Order Granting Approval of Proposed Rule Changes Relating to Clearly Erroneous Executions

I. Introduction

On April 17, 2014, BATS Exchange, Inc. (“BATS”), BATS-Y Exchange, Inc. (“BATS-Y”), NASDAQ OMX BX, Inc. (“BX”), EDGA Exchange, Inc. (“EDGA”), EDGX Exchange, Inc. (“EDGX”), Financial Industry Regulatory Authority, Inc. (“FINRA”), International Securities Exchange LLC (“ISE”), The NASDAQ Stock Market LLC (“Nasdaq”), National Stock Exchange, Inc. (“NSX”), and NASDAQ OMX PHLX LLC (“Phlx”) 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 proposed rule changes to amend certain of their respective rules relating to clearly erroneous transactions. On April 21, 2014, New York Stock Exchange LLC (“NYSE”), NYSE Arca, Inc. (“NYSE Arca”) and NYSE MKT LLC (“NYSE MKT”) filed with the Commission pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)³ and Rule 19b-4 thereunder,⁴ proposed rule changes to amend certain of their respective rules relating to clearly erroneous transactions. On April 22,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(1).

⁴ 17 CFR 240.19b-4.

2014, Chicago Stock Exchange, Inc. (“CHX”) filed with the Commission pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)⁵ and Rule 19b-4 thereunder,⁶ proposed rule changes to amend certain of its respective rules relating to clearly erroneous transactions. The proposed rule changes were published for comment in the Federal Register on May 6, 2014.⁷ The Commission received no comments on the proposed changes. This order approves the proposed rule changes.

II. Description of the Proposal

A. Background

The U.S. equity markets experienced a severe disruption on May 6, 2010.⁸ Severe price volatility led to a large number of trades being executed at temporarily depressed prices, including many that occurred at prices dramatically away from pre-decline levels. BATS, BX, CHX, EDGA, EDGX, ISE, Nasdaq, NSX, NYSE, NYSE Arca, NYSE MKT (collectively, and, together with BATS-Y and Phlx, the “Exchanges”) and FINRA (collectively, the “self-regulatory organizations” or the “SROs”) exercised their authority under their clearly erroneous executions rules to break trades that were effected at prices 60% or more away from pre-decline prices,

⁵ 15 U.S.C. 78s(b)(1).

⁶ 17 CFR 240.19b-4.

⁷ See Securities Exchange Act Release Nos. 72044 (April 30, 2014), 79 FR 25919; 72045 (April 30, 2014), 79 FR 25943; 72046 (April 30, 2014), 79 FR 25972; 72047 (April 30, 2014), 79 FR 25940; 72048 (April 30, 2014), 79 FR 25976; 72049 (April 30, 2014), 79 FR 25951; 72050 (April 30, 2014), 79 FR 25933; 72051 (April 30, 2014), 79 FR 25954; 72052 (April 30, 2014), 79 FR 25958; 72053 (April 30, 2014), 79 FR 25965; 72054 (April 30, 2014), 79 FR 25947; 72055 (April 30, 2014), 79 FR 25961; 72056 (April 30, 2014), 79 FR 25968; and 72057 (April 30, 2014), 79 FR 25937 (collectively, the “Notices”).

⁸ The events of May 6, 2010 are described more fully in the report of the staffs of the Commodity Futures Trading Commission (“CFTC”) and the Commission, titled Report of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues, “Preliminary Findings Regarding the Market Events of May 6, 2010,” dated May 18, 2010.

using a process that was not sufficiently clear or transparent to market participants. To clarify the clearly erroneous execution review process across all SROs, and reduce the discretion of the Exchanges and FINRA to deviate from the objective standards in their respective rules when dealing with clearly erroneous transactions, the Exchanges and FINRA filed proposed rule changes to, among other things, establish clear thresholds for when trades should be broken and to limit the discretion to deviate from specified percentage thresholds at which trades would be broken in many situations, including those where the single-stock circuit breakers are applicable and in other larger “Multi-Stock Events” involving five or more securities.⁹ These proposed rule changes were approved on a pilot basis by the Commission.¹⁰

In January 2013, the Exchanges and FINRA adopted a provision in their clearly erroneous executions rules designed to address the operation of the Plan to Address Extraordinary Market Volatility Pursuant to Rule 608 of Regulation NMS under the Act (the “Limit Up-Limit Down Plan”).¹¹ Subsequently, the Exchanges and FINRA removed the specific

⁹ See Securities Exchange Act Release Nos. 62330 (June 21, 2010), 75 FR 36725 (June 28, 2010); 62331 (June 21, 2010), 75 FR 36746 (June 28, 2010); 62332 (June 21, 2010), 75 FR 36749 (June 28, 2010); 62333 (June 21, 2010), 75 FR 36759 (June 28, 2010); 62334 (June 21, 2010), 75 FR 36732 (June 28, 2010); 62335 (June 21, 2010), 75 FR 37494 (June 29, 2010); 62336 (June 21, 2010), 75 FR 36743 (June 28, 2010); 62337 (June 21, 2010), 75 FR 36739 (June 28, 2010); 62338 (June 21, 2010), 75 FR 36762 (June 28, 2010); 62339 (June 21, 2010), 75 FR 36765 (June 28, 2010); 62340 (June 21, 2010), 75 FR 36768 (June 28, 2010); 62341 (June 21, 2010), 75 FR 36756 (June 28, 2010); and 62342 (June 21, 2010), 75 FR 36752 (June 28, 2010).

¹⁰ See Securities Exchange Act Release Nos. 62885 (September 10, 2010), 75 FR 56641 (September 16, 2010); 62886 (September 10, 2010), 75 FR 56613 (September 16, 2010).

¹¹ See Securities Exchange Release Nos. 68797 (January 31, 2013), 78 FR 8635 (February 6, 2013); 68798 (January 31, 2013), 78 FR 8628 (February 6, 2013); 68801 (February 1, 2013), 78 FR 8630 (February 6, 2013); 68802 (February 1, 2013), 78 FR 9092 (February 7, 2013); 68803 (February 1, 2013), 78 FR 9078 (February 7, 2013); 68804 (February 1, 2013), 78 FR 8677 (February 6, 2013); 68808 (February 1, 2013), 78 FR 9083 (February 7, 2013); 68809 (February 1, 2013), 78 FR 9081 (February 7, 2013); 68813 (February 1, 2013), 78 FR 9073 (February 7, 2013); 68814 (February 1, 2013), 78 FR 9086 (February 7, 2013); 68818 (February 1, 2013), 78 FR 9100 (February 7, 2013); 68819 (February 1,

provisions in the clearly erroneous executions rules related to individual stock trading pauses,¹² and recently extended the pilot program to coincide with the pilot period for the Limit Up-Limit Down Plan, including any extensions to the pilot period for the Limit Up-Limit Down Plan.¹³

B. The Proposed Rule Changes

The Exchanges and FINRA now propose to adopt two new provisions in their respective clearly erroneous executions rules, as discussed below. Additionally, the SROs propose to update certain cross-references in their clearly erroneous executions rules to reflect the addition of the new proposed rules. The proposals of each of the Exchanges and FINRA are substantially similar.¹⁴

2013), 78 FR 9438 (February 8, 2013); 68820 (February 1, 2013), 78 FR 9436 (February 8, 2013); and 68822 (February 4, 2013), 78 FR 9440 (February 8, 2013).

¹² See Securities Exchange Act Release Nos. 70510 (September 26, 2013), 78 FR 60991 (October 2, 2013); 70511 (September 26, 2013), 78 FR 60941 (October 2, 2013); 70512 (September 26, 2013), 78 FR 60965 (October 2, 2013); 70513 (September 26, 2013), 78 FR 60973 (October 2, 2013); 70514 (September 26, 2013), 78 FR 60963 (October 2, 2013); 70515 (September 26, 2013), 78 FR 60945 (October 2, 2013); 70516 (September 26, 2013), 78 FR 60952 (October 2, 2013); 70517 (September 26, 2013), 78 FR 60943 (October 2, 2013); 70518 (September 26, 2013), 78 FR 60950 (October 2, 2013); 70519 (September 26, 2013), 78 FR 60969 (October 2, 2013); 70529 (September 26, 2013), 78 FR 60977 (October 2, 2013); 70541 (September 27, 2013), 78 FR 61431 (October 3, 2013); 70542 (September 27, 2013), 78 FR 61427 (October 3, 2013); and 70589 (October 1, 2013), 78 FR 62782 (October 22, 2013).

¹³ See Securities Exchange Act Release Nos. 71781 (March 24, 2014), 79 FR 17615 (March 28, 2014); 71782 (March 24, 2014), 79 FR 17630 (March 28, 2014); 71783 (March 24, 2014), 79 FR 17617 (March 28, 2014); 71784 (March 24, 2014), 79 FR 17610 (March 28, 2014); 71785 (March 24, 2014), 79 FR 17621 (March 28, 2014); 71795 (March 25, 2014), 79 FR 18089 (March 31, 2014); 71796 (March 25, 2014), 79 FR 18099 (March 31, 2014); 71797 (March 25, 2014), 79 FR 18108 (March 31, 2014); 71806 (March 26, 2014), 79 FR 18375 (April 1, 2014); 71807 (March 26, 2014), 79 FR 18087 (March 31, 2014); 71808 (March 26, 2014), 79 FR 18355 (April 1, 2014); 71809 (March 26, 2014), 79 FR 18353 (April 1, 2014); 71820 (March 27, 2014), 79 FR 18595 (April 2, 2014); and 71821 (March 27, 2014), 79 FR 18592 (April 2, 2014).

¹⁴ While certain Exchanges only propose to permit an Exchange officer to declare transactions null and void for purposes of the proposed rules, BATS, BATS-Y, CHX, EDGA, EDGX, ISE, NSX and Phlx each propose to permit a senior level designee to act

1. Multi-Day Event Based on Fundamentally Incorrect or Grossly Misinterpreted Issuance Information

The Exchanges and FINRA propose to adopt a new paragraph in their respective clearly erroneous executions rules that would provide that a series of transactions in a particular security on one or more trading days may be viewed as one event if all such transactions were effected based on the same fundamentally incorrect or grossly misinterpreted issuance information (e.g., with respect to a stock split or corporate dividend) resulting in a severe valuation error for all such transactions (the “Multi-Day Event”).¹⁵

The Exchanges and FINRA propose that an officer of an Exchange or FINRA, or a senior level employee designee (as applicable) (collectively, “Officer”), acting on his or her own motion, shall take action to declare all transactions that occurred during the Multi-Day Event null and void not later than the start of trading on the day following the last transaction in the Multi-Day Event. If trading in the security is halted before the valuation error is corrected, the Officer shall take action to declare all transactions that occurred during the Multi-Day Event null and void prior to the resumption of trading. However, no action would be permitted pursuant to the

as an officer for purposes of the proposed rules and FINRA proposes to permit the executive vice president of its Market Regulation Department or Transparency Service Department or any officer designated by such executive vice president to act as a FINRA officer for purposes of the proposed rules. In addition, FINRA proposes to make additional changes to its rule addressing clearly erroneous transactions in exchange-listed securities, including replacing “market centers” and “markets” with “other self-regulatory organizations” to categorize the Exchanges and FINRA in the same manner (as self-regulatory organizations); and other technical or clarifying changes.

¹⁵ As an example of a Multi-Day Event contemplated by the proposed paragraph, the Notices refer to a specific event involving an exchange offer made by U.S. Bancorp on the NYSE in 2010, in which depositary shares of U.S. Bancorp traded over the course of a period of days at a price approximately one-tenth the actual value of the security (the “U.S. Bancorp Event”). The NYSE filed an emergency rule filing to nullify all trades occurring after the exchange offer at severely dislocated prices. See Notices, supra note 7 (describing Securities Exchange Act Release No. 62609 (July 30, 2010), 75 FR 47327 (August 5, 2010)).

proposed paragraph with respect to any transactions that have reached the settlement date for the security or that result from an initial public offering (“IPO”) of a security.

Further, the Exchanges and FINRA propose that to the extent transactions related to a Multi-Day Event involve one or more other SROs, the affected SROs would be required to promptly coordinate with each other to ensure consistent treatment of the transactions related to the Multi-Day Event, if practicable. The Exchanges and FINRA also propose that any action taken in connection with the proposed paragraph would be required to be taken without regard to the numerical guidelines set forth in the clearly erroneous executions rules of each Exchange and FINRA.¹⁶

The Exchanges and FINRA also propose to include a provision stating that each party involved in a transaction subject to the proposed paragraph would be required to be notified as soon as practicable of a determination to declare such transaction null and void, and that the party aggrieved by such action may appeal in accordance with the applicable appeals provision of each Exchange or FINRA’s clearly erroneous executions rules.¹⁷

2. Trading Halts

The Exchanges and FINRA also propose to adopt an additional paragraph in their respective clearly erroneous executions rules relating to transactions resulting from certain disruptions or malfunctions in connection with a regulatory trading halt, suspension or pause

¹⁶ See e.g., BATS Rule 11.17(c)(3); Nasdaq Rule 11890(a)(2)(C)(1); FINRA Rule 11892(b)(1). For example, an Officer would have the authority to nullify transactions resulting from a stock split that were based on fundamentally incorrect or grossly misinterpreted issuance information, even if such transactions were effected at prices consistent with the price at which the security was previously trading. The transactions in this particular example would not meet the applicable numerical guidelines, but would be considered clearly erroneous for purposes of the proposed paragraph because they should have been effected at prices well away from the actual execution prices.

¹⁷ See e.g., BATS Rule 11.17(e)(2); Nasdaq Rule 11890(c); FINRA Rule 11894.

(“trading halt”) in a security. Specifically, in the event of any disruption or malfunction in the operation of the electronic communications and trading facilities of an Exchange, another SRO, or responsible single plan processor in connection with the transmittal or receipt of a trading halt, an Officer, acting on his or her own motion, shall nullify any transaction that occurs after a trading halt has been declared by the primary listing market for a security and before such trading halt has officially ended according to the primary listing market. In addition, the Exchanges and FINRA propose that, in the event a trading halt is declared, then prematurely lifted in error, and then re-instituted, an Officer, acting on his or her own motion shall nullify transactions that occur before the official, final end of the trading halt according to the primary listing market. In the event that a trading halt is declared as of a future time, the Exchanges and FINRA would nullify only those transactions occurring after the time the trading halt was supposed to be in place until the official end of the trading halt according to the primary listing market.

The Exchanges and FINRA propose that any action taken in connection with the proposed paragraph would be taken in a timely fashion, generally within thirty minutes of the detection of the erroneous transaction and in no circumstances later than the start of regular market hours, generally between 9:30 AM EST to 4:00 PM EST, on the trading day following the date of execution(s) under review. The Exchanges and FINRA also propose that any action taken in connection with the proposed rule would be required to be taken without regard to the numerical guidelines set forth in their respective clearly erroneous executions rules¹⁸ because such transactions should not have occurred during a trading halt, and thus, nullifying them, or declaring them null and void would not put the parties in a different position. Lastly, the

¹⁸ See supra note 16.

Exchanges and FINRA also propose to include a provision stating that each party involved in a transaction subject to the proposed paragraph would be required to be notified as soon as practicable of a determination to nullify such transaction, and that the party aggrieved by such action may appeal in accordance with the applicable appeals provision of each Exchange or FINRA's clearly erroneous executions rules.¹⁹

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to national securities exchanges and national securities associations.²⁰ In particular, the Commission finds that the proposed rule changes submitted by the Exchanges and FINRA are consistent with the requirements of Section 6(b)(5) of the Act²¹ (in the case of the Exchanges) and Section 15A(b)(6) of the Act²² (in the case of FINRA) which require, among other things, that the rules of national securities exchanges and FINRA, respectively, must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, 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.

In the Commission's view, the proposed rule changes will continue to 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 changes also should help continue to assure consistent

¹⁹ See supra note 17.

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. 78o-3(b)(6).

results in handling erroneous trades across the U.S. markets, thus furthering fair and orderly markets and the protection of investors and the public interest. Specifically, the Commission believes that the provision relating to the handling of Multi-Day Events effected based on the same fundamentally incorrect or grossly misinterpreted issuance information that results in a severe valuation error should contribute to a more transparent process, and help achieve a fair and equitable result, on the very rare occasions such events occur. The Commission believes that the proposed trading halt provision should help to increase certainty and transparency with respect to transactions that inadvertently occur during trading halts due to a technology failure. The Commission notes that these transactions should not have occurred in the first place, and that the proposed rule change provides certainty to market participants that these transactions will be nullified promptly through an objective and transparent process.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²³ that the proposed rule changes, SR-BATS-2014-014; SR-BX-2014-021; SR-BYX-2014-007; SR-CHX-2014-06; SR-EDGA-2014-11; SR-EDGX-2014-12; SR-FINRA-2014-021; SR-ISE-2014-25; SR-NASDAQ-2014-044; SR-NSX-2014-08; SR-NYSE-2014-22; SR-NYSEArca-2014-48; SR-NYSEMKT-2014-37; SR-Phlx-2014-27, be, and hereby are, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁴

Kevin M. O'Neill
Deputy Secretary

²³ 15 U.S.C. 78s(b)(2).

²⁴ 17 CFR 200.30-3(a)(12).