

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-62341; File No. SR-FINRA-2010-032)

June 21, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Amend FINRA Rule 11892 (Clearly Erroneous Transactions in Exchange-Listed Securities)

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 June 17, 2010, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. 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 Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA Rule 11892 (Clearly Erroneous Transactions in Exchange-Listed Securities).

The text of the proposed rule change is available on FINRA’s Web site at <http://www.finra.org>, at the principal office of FINRA 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, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV

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

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

below. FINRA 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

FINRA is proposing modifications to its Rule 11892, entitled Clearly Erroneous Transactions in Exchange-Listed Securities ("the Rule"). First, FINRA proposes replacing existing paragraph (b)(2) of the Rule, entitled "Alternative Reference Prices" with a new paragraph, entitled "Multi-Stock Events Involving Twenty or More Securities." Second, FINRA is replacing existing paragraph (b)(4) of the Rule, entitled "Numerical Guidelines Applicable to Volatile Market Opens" with a new paragraph, entitled "Individual Stock Trading Pauses." Third, FINRA is combining paragraphs (a)(1) and (a)(2) into one paragraph to provide that paragraph (b) governs the review of all transactions reported to a FINRA trade reporting system, whether or not there are similarly situated transactions in the security on a national securities exchange. Finally, FINRA proposes modifications to paragraphs (b)(1) and (b)(3) of the Rule consistent with the proposed changes to paragraphs (b)(2) and (b)(4). The provisions of this proposed rule change shall be in effect during a pilot period set to end on December 10, 2010. If the pilot is not extended or approved as permanent by December 10, 2010, the prior version of this Rule shall be in effect.

FINRA is proposing the rule changes described herein in consultation with other self-regulatory organizations ("SROs") and Commission staff to provide for uniform treatment: (1) of clearly erroneous execution reviews in Multi-Stock Events involving twenty or more securities; and (2) in the event transactions occur that result in the issuance of an individual stock trading pause by the primary listing market and subsequent transactions that occur before the trading pause is in effect for transactions otherwise than on an exchange. FINRA also has proposed additional

changes to the Rule that reduce the ability of FINRA to deviate from the objective standards set forth in the Rule. The proposed changes are described in further detail below.

Revised Paragraph (b)(2) Related to Multi-Stock Events Involving Twenty or More Securities

FINRA proposes to eliminate the text of existing paragraph (b)(2), which provides flexibility to FINRA to use different Numerical Guidelines or Reference Prices in various “Unusual Circumstances.” FINRA proposes to replace the text of this paragraph with new language that would apply to Multi-Stock Events involving twenty or more securities whose executions occurred within a period of five minutes or less. The revised paragraph would provide that during Multi-Stock Events involving twenty or more securities the number of affected transactions may be such that immediate finality is necessary to maintain a fair and orderly market and to protect investors and the public interest. Accordingly, as set forth in paragraph (a)(2), in such circumstances, decisions made by FINRA in consultation with the markets could not be appealed. Further, as proposed, in connection with reviews of Multi-Stock Events involving twenty or more securities, FINRA may use a Reference Price other than consolidated last sale in its review of potentially clearly erroneous executions. With the exception of those securities under review that are subject to an individual stock trading pause as described in proposed paragraph (b)(4), and to ensure consistent application across market centers when proposed paragraph (b)(2) is invoked, FINRA will promptly coordinate with the other market centers to determine the appropriate review period, which may be greater than the period of five minutes or less that triggered application of proposed paragraph (b)(2), as well as select one or more specific points in time prior to the transactions in question and use transaction prices at or immediately prior to the one or more specific points in time selected as the Reference Price. FINRA will nullify as clearly erroneous all transactions that are at prices equal to or

greater than 30% away from the Reference Price in each affected security during the review period selected by FINRA and the markets consistent with the proposed paragraph (b)(2).

Because FINRA and the market centers are adopting a different threshold and standards to handle large-scale market events, which would include events occurring during times of high volatility at the beginning of regular trading hours, FINRA proposes deletion of paragraph (b)(4) (“Numerical Guidelines Applicable to Volatile Market Opens”) of the existing rule. FINRA believes that this provision is no longer necessary, and if maintained, could result in extremely high Numerical Guidelines (up to 90%) in certain circumstances.

#### Revised Paragraph (b)(4) Related to Individual Stock Trading Pauses

Several SROs recently amended their rules so that they may, from time to time, issue a trading pause for an individual security if the price of such security moves 10% or more from a sale in a preceding five-minute period. In this regard, the SEC recently approved a proposed rule change by FINRA to halt trading in an individual stock when the primary listing market for such stock issues a trading pause in any security under its rules.<sup>3</sup> As described above, FINRA is proposing to eliminate existing paragraph (b)(4) (“Numerical Guidelines Applicable to Volatile Market Opens”). FINRA proposes adopting a provision, numbered as paragraph (b)(4) following such elimination, which will provide for uniform treatment of clearly erroneous execution reviews in the event transactions occur that result in the issuance of an individual stock trading pause by the primary listing market and subsequent transactions that occur before the trading pause is in effect for transactions otherwise than on an exchange. The proposed rule change is necessary to provide greater certainty of the clearly erroneous Reference Price for transactions that trigger a trading pause (the “Trigger Trade”) and subsequent transactions occurring between the time of the Trigger

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<sup>3</sup> See Securities Exchange Act Release No. 62251 (June 10, 2010), 75 FR 34183 (June 16, 2010) (Order Approving File No. SR-FINRA-2010-025).

Trade and the time the trading pause message is received by FINRA from the single plan processor responsible for consolidation and dissemination of information for the security and put into effect by FINRA for transactions otherwise than on an exchange, especially under highly volatile and active market conditions.

FINRA proposes to use the price that triggered a trading pause in an individual stock (the “Trading Pause Trigger Price”) as the Reference Price for clearly erroneous execution reviews of a Trigger Trade and transactions that occur immediately after a Trigger Trade but before a trading halt is in effect for transactions otherwise than on an exchange. As proposed, the phrase “Trading Pause Trigger Price” shall mean the price that triggered a trading pause on a primary listing market. The Trading Pause Trigger Price reflects a price calculated by the primary listing market over a rolling five-minute period and may differ from the execution price of a transaction that triggered a trading pause. FINRA will rely on the primary listing market that issued an individual stock trading pause to determine and communicate the Trading Pause Trigger Price for such stock. FINRA proposes to make clear in the text that the proposed standards in paragraph (b)(4) apply regardless of whether the security at issue is part of a Multi-Stock Event involving five or more securities as described in proposed paragraphs (b)(1) and (b)(2).

As proposed, the Numerical Guidelines set forth in paragraph (b)(1) of the Rule, other than those Numerical Guidelines applicable to Multi-Stock Events, would apply to reviews of Trigger Trades and subsequent transactions. FINRA proposes to review all transactions that trigger a trading pause and subsequent transactions occurring before the trading pause is in effect for transactions otherwise than on an exchange. Where a trading pause was triggered by a price decline (rise), FINRA shall deem as clearly erroneous all such transactions that occurred at a price lower (higher) than the Trading Pause Trigger Price. Because the proposed rules for trading pauses

would only apply within Regular Trading Hours, an execution would be reviewed and nullified as clearly erroneous as follows:

Reference Price or Product	Numerical Guidelines (Subject transaction's % difference from the Trading Pause Trigger Price):
Greater than \$0.00 up to and including \$25.00	10%
Greater than \$25.00 up to and including \$50.00	5%
Greater than \$50.00	3%
Leveraged ETF/ETN securities	Regular Trading Hours Numerical Guidelines multiplied by the leverage multiplier (i.e. 2x)

Trades occurring after a trading halt is in effect may be deemed in violation of FINRA Rule 5260 (Prohibition on Transactions, Publication of Quotations, or Publication of Indications of Interest During Trading Halts) and will be deemed clearly erroneous.

FINRA reminds members that they must have policies and procedures in place that are reasonably designed to ensure that, among other things, members promptly cease effecting transactions during a halt as required by FINRA Rule 5260.

Additional Conforming Revisions to Paragraphs (b)(1) and (b)(3)

Based on proposed paragraph (b)(2), FINRA has proposed certain conforming changes to paragraphs (b)(1) and (b)(3) of the existing Rule, as described below.

Under current FINRA Rule 11892, a transaction may be found to be clearly erroneous only if the price of the transaction to buy (sell) that is the subject of the complaint is greater than (less than) the Reference Price by an amount that equals or exceeds the Numerical Guidelines set forth in paragraph (b)(1) of the Rule. The “Reference Price” is currently defined as the consolidated last sale immediately prior to the execution(s) under review except for in Unusual Circumstances as described in paragraph (b)(2) of the Rule. FINRA proposes modifying paragraph (b)(1) consistent with the changes described above such that FINRA shall use the consolidated last sale immediately prior to the execution(s) under review as the Reference Price except for: (A) Multi-Stock Events involving twenty or more securities, as described in proposed paragraph (b)(2); (B) transactions not involving a Multi-Stock Event as described in proposed paragraph (b)(2) that trigger a trading pause and subsequent transactions, as described in proposed paragraph (b)(4), in which case the Reference Price shall be determined in accordance with that paragraph (b)(4); and (C) in other circumstances, such as, for example, relevant news impacting a security or securities, periods of extreme market volatility, sustained illiquidity, or widespread system issues, where use of a different Reference Price is necessary for the maintenance of a fair and orderly market and the protection of investors and the public interest. FINRA also proposes modifying paragraph (b)(1) to reduce uncertainty as to the applicability of the Numerical Guidelines, by requiring a finding that an execution was clearly erroneous if such execution exceeds the Numerical Guidelines, subject only to the Additional Factors included in paragraph (b)(3). Moreover, FINRA proposes revising the existing description for Multi-Stock Events that is contained on the Numerical Guidelines chart to make clear that different Numerical Guidelines apply for Multi-Stock Events involving five or more, but less than twenty, securities whose executions occurred within a period of five minutes or less. In addition, FINRA proposes adding to the Numerical Guidelines chart a row that contains

the Numerical Guidelines (30%) for Multi-Stock Events involving twenty or more securities whose executions occurred within a period of five minutes or less.

FINRA proposes clarifying paragraph (b)(3) to make clear that the additional factors set forth in that paragraph are not intended to provide any discretion to a FINRA official to deviate from the guidelines that apply to Multi-Stock Events or to transactions in securities subject to individual stock trading pauses. FINRA also is combining paragraphs (a)(1) and (a)(2) into one paragraph to provide that paragraph (b) governs the review of all transactions reported to a FINRA trade reporting system, whether or not there are similarly situated transactions in the security on a national securities exchange. Existing paragraph (a)(3) of the Rule will be renumbered as (a)(2).

Consistent with the exchanges, FINRA is proposing that the provisions of this proposed rule change shall be in effect during a pilot period set to end on December 10, 2010. If the pilot is not extended or approved as permanent by December 10, 2010, the prior version of this Rule shall be in effect.

FINRA has requested that the Commission approve the proposed rule change on an accelerated basis, so that it may become operative as soon as possible based on the fact that the proposed trading pause rules adopted by FINRA and several national securities exchanges have now become fully operative subject to the initial pilot program.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>4</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect investors and the public interest. FINRA believes

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<sup>4</sup> 15 U.S.C. 78q-3(b)(6).

that the proposed rule change is consistent with the clearly erroneous rules of other SROs and will promote the goal of transparency and uniformity across markets concerning reviews of potentially clearly erroneous executions in various contexts, including reviews in the context of a Multi-Stock Event involving twenty or more securities and reviews resulting from a Trigger Trade and any executions occurring immediately after a Trigger Trade but before a trading halt is in effect for transactions otherwise than on an exchange. Further, FINRA believes that the proposed changes enhance the objectivity of decisions made by FINRA with respect to clearly erroneous executions.

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

FINRA 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.

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 35 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 self-regulatory organization consents, the Commission will:

(A) by order approve 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-FINRA-2010-032 on the subject line.

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-FINRA-2010-032. 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 Web site (<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 Web site 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 office of FINRA. 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 publicly available. All submissions should refer to File Number SR-FINRA-2010-032 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>5</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>5</sup> 17 CFR 200.30-3(a)(12).