

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-65425; File No. SR-ISE-2011-61)

September 28, 2011

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Proposed Rule Change Related to Trading Halts Due to Extraordinary Market Volatility

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 September 27, 2011, the International Securities Exchange, LLC (“Exchange” or “ISE”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. 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

The Exchange proposes to adopt Rule 2102(g) to set forth the methodology for determining when trading in all stocks will be halted due to extraordinary market volatility.

The text of the proposed rule change is available on the Exchange’s Internet website at <http://www.ise.com>, at the principal office of the Exchange, at the Commission’s Public Reference Room, and at the Commission’s website at [www.sec.gov](http://www.sec.gov).

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization 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

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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. The self-regulatory organization 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 adopt section (g) of Rule 2102 to set forth the current methodology for determining when trading in all stocks will be halted due to extraordinary market volatility. The Exchange is proposing this rule change in consultation with other equity, options and futures markets, the Financial Industry Regulatory Authority, Inc. (“FINRA”) and staffs of the Commission and the Commodity Futures Trading Commission.

Since May 6, 2010, when the markets experienced excessive volatility in an abbreviated time period, i.e., the “flash crash,” the exchanges and FINRA have implemented market-wide measures designed to restore investor confidence by reducing the potential for excessive market volatility. Among the measures adopted include pilot plans for stock-by-stock trading pauses<sup>3</sup> and related changes to the clearly erroneous execution rules.<sup>4</sup> In addition, on April 5, 2011, the equities exchanges and FINRA filed a plan pursuant to Rule 608 of Regulation NMS to address extraordinary market volatility (the “Limit Up-Limit Down Plan”).<sup>5</sup> As proposed, the Limit Up-Limit Down Plan is designed to prevent trades in individual NMS stocks from occurring outside specified price bands.

The Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues (“Committee”) has recommended that, in addition to the initiatives already adopted or proposed,

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<sup>3</sup> ISE Rule 2102(f).

<sup>4</sup> ISE Rule 2128.

<sup>5</sup> See Securities Exchange Act Release No. 64547 (May 25, 2011), 76 FR 31647 (June 1, 2011).

the markets should consider reforming the existing market-wide circuit breakers. Among other things, the Committee noted that the interrelatedness of today's highly electronic markets warrants the need to review the present operation of the system-wide circuit breakers now in place. Specifically, the Committee recommended that the markets consider replacing the Dow Jones Industrial Average ("DJIA") with the S&P 500<sup>®</sup> Index ("S&P 500"), revising the 10%, 20% and 30% decline percentages, reducing the length of trading halts, and allowing halts to be triggered up to 3:30 p.m.<sup>6</sup>

The exchanges and FINRA have taken into consideration the Committee's recommendations, and with some modifications, have proposed changes to market-wide circuit breakers. The Exchange believes these proposed changes will provide for a more meaningful measure, in today's faster, more electronic markets, of when to halt stocks on a market-wide basis as a result of rapid market declines.

#### Background

New York Stock Exchange ("NYSE") Rule 80B provides for market-wide halts in trading at specified levels in order to promote stability and investor confidence during a period of significant stress. As the Commission noted in its approval order, the rule was intended to enable market participants to establish equilibrium between buying and selling interest and to ensure that market participants have an opportunity to become aware of and respond to

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<sup>6</sup> See Summary Report of the Committee, "Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010" (Feb, 18, 2011). The Exchange notes that NYSE Euronext submitted a comment letter to the Committee that recommended, among other things, reform of the market-wide circuit breaker rules. See Letter to Elizabeth Murphy, Secretary, Commission, from Janet M. Kissane, SVP and Corporate Secretary, NYSE Euronext (July 19, 2010). The proposed reforms set forth in this rule proposal differ slightly from the changes recommended in that comment letter, and represent consensus among the markets of how to address reform of the market-wide circuit breakers.

significant price movements. Importantly, the market-wide circuit breakers were not intended to prevent markets from adjusting to new price levels; rather, they provide for a speed bump for extremely rapid market declines.<sup>7</sup>

In its current form, the rule provides for Level 1, 2 and 3 declines and specified trading halts following such declines (each a “Level 1, 2 or 3 Halt,” respectively). The values of Levels 1, 2 and 3 are calculated at the beginning of each calendar quarter by the primary listing market, using 10%, 20% and 30%, respectively, of the average closing value of the DJIA for the month prior to the beginning of the quarter. Each percentage calculation is rounded to the nearest fifty points to create the levels’ trigger points. The primary listing markets disseminate the new trigger levels quarterly to the media, via information memos and publication on their websites. The values then remain in effect until the next quarterly calculation, notwithstanding whether the DJIA has moved and a Level 1, 2 or 3 decline is no longer equal to an actual 10%, 20% or 30% decline in the most recent closing value of the DJIA.

Once a NYSE Rule 80B circuit breaker is in effect, trading in all stocks halt for the time periods specified below:

Level 1 Halt

anytime before 2:00 p.m. – one hour;

at or after 2:00 p.m. but before 2:30 p.m. – 30 minutes;

at or after 2:30 p.m. – trading shall continue, unless there is a Level 2 Halt.

Level 2 Halt

anytime before 1:00 p.m. – two hours;

at or after 1:00 p.m. but before 2:00 p.m. – one hour;

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<sup>7</sup> See Securities Exchange Act Release No. 26198 (Oct. 19, 1988).

at or after 2:00 p.m. – trading shall halt and not resume for the rest of the day.

#### Level 3 Halt

at any time – trading shall halt and not resume for the rest of the day.

Unless stocks are halted for the remainder of the trading day, price indications are disseminated by the primary listing market during a NYSE Rule 80B trading halt for stocks that comprise the DJIA.

#### Proposed Amendments

As noted above, the Exchange, other equities, options, and futures markets, and FINRA propose to amend the market-wide circuit breakers to take into consideration the recommendations of the Committee, and to provide for more meaningful measures in today's markets of when to halt trading in all stocks. Accordingly, the Exchange proposes to adopt Rule 2102(g), which will reflect the follows [sic] changes to current NYSE Rule 80B: (i) replace the DJIA with the S&P 500; (ii) replace the quarterly calendar recalculation of NYSE Rule 80B triggers with daily recalculations; (iii) replace the 10%, 20% and 30% market decline percentages with 7%, 13% and 20% market decline percentages (each a "Level 1, 2 or 3 Market Decline," respectively); (iv) modify the length of the trading halts associated with each market decline level; and (v) modify the times when a trading halt may be triggered. The Exchange believes that these proposed amendments update the rule to reflect today's high-speed, highly electronic trading market while still meeting the original purpose of the rule: to ensure that market participants have an opportunity to become aware of and respond to significant price movements.

First, the Exchange proposes to replace the DJIA with the S&P 500. The Exchange believes that because the S&P 500 is based on the trading prices of 500 stocks, as compared to

the 30 stocks that comprise the DJIA, the S&P 500 represents a broader base of securities against which to measure whether extraordinary market-wide volatility is occurring. In addition, as noted by the Committee, using an index that correlates closely with derivative products, such as the E-Mini and SPDR S&P 500 Exchange-Traded Fund (“SPY”), will allow for a better cross-market measure of market volatility.

Second, the Exchange proposes to change the recalculation of the trigger values from once every calendar quarter to daily. The Exchange believes that updating the trigger values daily will better reflect current market conditions. In particular, a daily recalculation will ensure that the percentage drop triggers relate to current market conditions, and are not compared to what may be stale market conditions. As noted in the proposed rule, the daily calculations of the trigger values will be published before the trading day begins.<sup>8</sup>

Third, the Exchange proposes to decrease the current Level 1, 2 and 3 declines of 10%, 20% and 30% to a Level 1 Market Decline of 7%, a Level 2 Market Decline of 13% and Level 3 Market Decline of 20%. In particular, as demonstrated by the May 6, 2010 flash crash, the current Level 1 10% decline may be too high a threshold for determining whether to halt trading across all securities. In fact, since adoption, the markets have halted only once, on October 27, 1997.<sup>9</sup> Accordingly, to reflect the potential that a lower, yet still significant decline may warrant a market-wide trading halt, the Exchange proposes to lower the market decline percentage thresholds.

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<sup>8</sup> The primary listing markets will advise via Trader Update the specific methodology for publishing the daily calculations, as well as the manner by which the markets will halt trading in all stocks should a Rule 11.14 trading halt be triggered.

<sup>9</sup> At that time, the triggers were based on absolute declines in the DJIA (350 point decrease for a Level 1 halt and 550 point decrease for a Level 2 halt).

As further proposed, trading on the Exchange will be halted based on a Level 1 or Level 2 Market Decline only once per day. For example, if a Level 1 Market Decline was to occur and trading was halted, following the re-opening of trading, trading would not halt again unless a Level 2 Market Decline was to occur. Likewise, following the re-opening of trading after a Level 2 Market Decline, trading would not be halted again unless a Level 3 Market Decline was to occur, at which point, trading in all stocks would be halted until the primary listing market opens the next trading day.

Fourth, to correspond with the lower percentages associated with triggering a trading halt, the Exchange also proposes to shorten the length of the market-wide trading halts associated with each level. As proposed, a Level 1 or 2 Market Decline occurring after 9:30 a.m. Eastern Time (“ET”)<sup>10</sup> and up to and including 3:25 p.m. ET, would result in a trading halt in all stocks for 15 minutes.

The Exchange believes that by reducing the percentage threshold, coupled with the reduced length of a trading halt, the proposed rule would allow for trading halts for serious market declines, while at the same time, would minimize disruption to the market by allowing for trading to continue after the proposed more-abbreviated trading halt. The Exchange believes that in today’s markets, where trading information travels in micro-second speeds, a 15-minute trading halt strikes the appropriate balance between the need to halt trading for market participants to assess the market, while at the same time reducing the time that the market is halted.

Finally, because the proposed Level 1 and Level 2 trading halts will now be 15 minutes, the Exchange proposes amending the rule to allow for a Level 1 or 2 Market Decline to trigger a

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<sup>10</sup> The Exchange notes that all times listed throughout this filing are in Eastern Time.

trading halt up to 3:25 p.m. Under the current rule, a trading halt cannot be triggered after 2:30 p.m., and this time corresponds to the need for the markets both to re-open following a 30-minute halt and to engage in a fair and orderly closing process. However, as the markets experienced on May 6, 2010, even if the Level 1 decline had occurred that day, because the market decline occurred after 2:30 p.m., it would not have triggered a halt under the current rule. The Committee recommended that trading halts be triggered up to 3:30 p.m. The Exchange agrees that the proposed amendments must strike the appropriate balance between permitting trading halts as late in the day as feasible without interrupting the closing process.

Accordingly, to accommodate existing primary listing market rules concerning closing procedures, including the publication of imbalance information beginning at 3:45 p.m. and the restrictions on entry and cancellation of market on close (“MOC”) and limit on close (“LOC”) orders after 3:45 p.m.,<sup>11</sup> the Exchange proposes that the last Level 1 or Level 2 Market Decline trading halt should be 3:25 p.m. The Exchange proposes 3:25 p.m. as the cut-off time so that there is time following the 15-minute trading halt for the markets to re-open before the 3:45 p.m. cut-off for entry and cancellation of MOC and LOC orders under primary listing market rules.<sup>12</sup>

As with current Level 3 declines, under the proposed rule, a Level 3 Market Decline would halt trading for the remainder of the trading day, including any trading that may take place after 4:00 p.m. and would not resume until the next trading day.

In addition to these proposed changes, the Exchange proposes to add to Rule 2102(g) how the Exchange will re-open following a 15 minute trading halt and to Rule 2102(f) how the Exchange will re-open following a 10 minute trading pause. In particular, the Exchange proposes that if the primary listing market halts trading in all stocks, the Exchange will halt

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<sup>11</sup> See, e.g., NYSE Rule 123C.

<sup>12</sup> Id.



trading in those stocks until the primary listing market has resumed trading or notice has been provided by the primary listing market that trading may resume. As further proposed, if the primary listing market does not re-open a security within 15 minutes following the end of the trading halt, or within 10 minutes following the end of a trading pause, the Exchange may resume trading in that security.

As a result of the proposed changes described above, the Exchange proposes to clarify that 2102(e) applies to trading halts in new derivative securities, so as to not be confused with newly proposed provisions for trading halts in 2102(g). ISE Rule 2102(e) governs trading halts in new derivative securities products when a temporary interruption occurs in the calculation or wide dissemination of the intraday indicative value (“IIV”) or the value of the underlying index by a major market data vendor. Therefore, ISE is clarifying that this subsection applies to halts in new derivative securities products and proposed ISE Rule 2102(g) applies to trading halts due to extraordinary market volatility.

## 2. Statutory Basis

The statutory basis for the proposed rule change is Section 6(b)(5) of the Act,<sup>13</sup> which require that an Exchange have rules that are designed to promote just and equitable principles of trade, 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. Specifically, this rule proposal supports the objectives of perfecting the mechanism of a free and open market and the national market system because it promotes uniformity across markets concerning when and how to halt trading in all stocks as a result of extraordinary market volatility.

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<sup>13</sup> 15 U.S.C. 78f(b)(5).

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

The proposed rule change does not impose 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

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from members or other interested parties.

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 self-regulatory organization consents, the Commission will:

- (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 changes to the market-wide circuit breaker regime are consistent with the Act. The Commission specifically requests comment on the following:

- As discussed above, the proposed rule change would narrow the percentage market declines that would trigger a market-wide halt in trading. How would the proposed

changes interact with the existing single-stock circuit breaker pilot program<sup>14</sup> or, if approved, the proposed NMS Plan to establish a limit-up/limit-down mechanism for individual securities?<sup>15</sup>

- To what extent could the concurrent triggering of single stock circuit breakers in many S&P 500 Index stocks lead to difficulties in calculating the index? Would the triggering of many single stock circuit breakers in a general market downturn cause the index calculation to become stale and thereby delay the triggering of the market-wide circuit breaker?
- Should the market-wide circuit breaker be triggered if a sufficient number of single-stock circuit breakers or price limits are triggered, and materially affect calculations of the S&P 500 Index?
- Should market centers implement rules that mandate cancellation of pending orders in the event a market-wide circuit breaker is triggered? If so, should such a rule require cancellation of all orders or only certain order types (e.g., limit orders)? Should all trading halts trigger such cancellation policies or should the cancellation policies apply only to a Level 3 Market Decline?
- Should some provision be made to end the regular trading session if a market decline suddenly occurs after 3:25 p.m. but does not reach the 20% level?

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<sup>14</sup> See Securities Exchange Act Release No. 64735 (June 23, 2011), 76 FR 38243 (June 29, 2011) (SR-BATS-2011-016; SR-BYX-2011-011; SR-BX-2011-025; SR-CBOE-2011-049; SR-CHX-2011-09; SR-EDGA-2011-15; SR-EDGX-2011-14; SR-FINRA-2011-023; SR-ISE-2011-028; SR-NASDAQ-2011-067; SR-NYSE-2011-21; SR-NYSEAmex-2011-32; SR-NYSEArca-2011-26; SR-NSX-2011-06; SR-Phlx-2011-64) (approving the “Phase III Pilot Program”). The Phase III Pilot Program has been extended through January 2012. See, e.g., Securities Exchange Act Release 65094 (August 10, 2011), 76 FR 50779 (August 16, 2011) (SR-NASDAQ-2011-011).

<sup>15</sup> See Securities Exchange Act Release No. 64547 (May 25, 2011), 76 FR 31647 (June 1, 2011).

- In the event of a Level 3 Market Decline, should some provision be made for the markets to hold a closing auction?
- Should the primary market have a longer period (e.g., 30 minutes) to reopen trading following a Level 2 Market Decline before trading resumes in other venues?
- In the event of a Level 3 Market Decline, should the markets wait for the primary market to reopen trading in a particular security on the next trading day before trading in that security resumes?

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-ISE-2011-61 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-ISE-2011-61. 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 office 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 publicly available. All submissions should refer to File Number SR-ISE-2011-61 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>16</sup>

Elizabeth M. Murphy  
Secretary

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<sup>16</sup> 17 CFR 200.30-3(a)(12).