

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69333; File No. SR-NASDAQ-2013-043)

April 5, 2013

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Approving, on an Accelerated Basis, Proposed Rule Change to Adopt Chapter V, Section 3(d)(iii) Regarding Quoting Obligations

I. Introduction

On March 5, 2013, The NASDAQ Stock Market LLC (“NASDAQ” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (“Act”),² and Rule 19b-4 thereunder,³ a proposed rule change to adopt Chapter V, Section 3(d)(iii) regarding quoting obligations. The proposed rule change was published for comment in the Federal Register on March 13, 2013.⁴ The Commission received no comment letters on the proposal. This order approves the proposed rule change on an accelerated basis.

II. Background

On May 6, 2010, the U.S. equity markets experienced a severe disruption that, among other things, resulted in the prices of a large number of individual securities suddenly declining by significant amounts in a very short time period before suddenly reversing to prices consistent with their pre-decline levels.⁵ This severe price volatility led to a large number of trades being

¹ 15 U.S.C. 78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

⁴ See Securities Exchange Act Release No. 69069 (March 7, 2013), 78 FR 15995.

⁵ The events of May 6 are described more fully in a joint report by the staffs of the Commodity Futures Trading Commission (“CFTC”) and the Commission. See Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues, “Findings Regarding the Market Events of May 6, 2010,” dated

executed at temporarily depressed prices, including many that were more than 60% away from pre-decline prices. One response to the events of May 6, 2010, was the development of the single-stock circuit breaker pilot program, which was implemented through a series of rule filings by the equity exchanges and by FINRA.⁶ The single-stock circuit breaker was designed to reduce extraordinary market volatility in NMS stocks by imposing a five-minute trading pause when a trade was executed at a price outside of a specified percentage threshold.⁷

To replace the single-stock circuit breaker pilot program, the equity exchanges filed a National Market System Plan⁸ pursuant to Section 11A of the Act,⁹ and Rule 608 thereunder,¹⁰

September 30, 2010, available at <http://www.sec.gov/news/studies/2010/marketevents-report.pdf>.

⁶ For further discussion on the development of the single-stock circuit breaker pilot program, see Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (“Limit Up-Limit Down Plan” or “Plan”).

⁷ See Securities Exchange Act Release Nos. 62884 (September 10, 2010), 75 FR 56618 (September 16, 2010) and Securities Exchange Act Release No. 62883 (September 10, 2010), 75 FR 56608 (September 16, 2010) (SR-FINRA-2010-033) (describing the “second stage” of the single-stock circuit breaker pilot) and Securities Exchange Act Release No. 64735 (June 23, 2011), 76 FR 38243 (June 29, 2011) (describing the “third stage” of the single-stock circuit breaker pilot).

⁸ NYSE Euronext filed on behalf of New York Stock Exchange LLC (“NYSE”), NYSE Amex LLC (“NYSE Amex”), and NYSE Arca, Inc. (“NYSE Arca”), and the parties to the proposed National Market System Plan, BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Incorporated (“CBOE”), Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, the Nasdaq Stock Market LLC, and National Stock Exchange, Inc. (collectively with NYSE, NYSE MKT, and NYSE Arca, the “Participants”). On May 14, 2012, NYSE Amex filed a proposed rule change on an immediately effective basis to change its name to NYSE MKT LLC (“NYSE MKT”). See Securities Exchange Act Release No. 67037 (May 21, 2012) (SR-NYSEAmex-2012-32).

⁹ 15 U.S.C. 78k-1.

¹⁰ 17 CFR 242.608.

which featured a “limit up-limit down” mechanism (as amended, the “Limit Up-Limit Down Plan” or “Plan”).

The Plan sets forth requirements that are designed to prevent trades in individual NMS stocks from occurring outside of the specified price bands. The price bands consist of a lower price band and an upper price band for each NMS stock. When one side of the market for an individual security is outside the applicable price band, i.e., the National Best Bid is below the Lower Price Band, or the National Best Offer is above the Upper Price band, the Processors¹¹ are required to disseminate such National Best Bid or National Best Offer¹² with a flag identifying that quote as non-executable. When the other side of the market reaches the applicable price band, i.e., the National Best Offer reaches the lower price band, or the National Best Bid reaches the upper price band, the market for an individual security enters a 15-second Limit State, and the Processors are required disseminate such National Best Offer or National Best Bid with an appropriate flag identifying it as a Limit State Quotation. Trading in that stock would exit the Limit State if, within 15 seconds of entering the Limit State, all Limit State Quotations were executed or canceled in their entirety. If the market does not exit a Limit State within 15 seconds, then the Primary Listing Exchange will declare a five-minute trading pause, which is applicable to all markets trading the security.

The Primary Listing Exchange may also declare a trading pause when the stock is in a Straddle State, i.e., the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band and the NMS Stock is not in a Limit State. In order to declare a trading pause in this scenario,

¹¹ As used in the Plan, the Processor refers to the single plan processor responsible for the consolidation of information for an NMS Stock pursuant to Rule 603(b) of Regulation NMS under the Exchange Act. See id.

¹² “National Best Bid” and “National Best Offer” has the meaning provided in Rule 600(b)(42) of Regulation NMS under the Exchange Act. See id.

the Primary Listing Exchange must determine that trading in that stock deviates from normal trading characteristics such that declaring a trading pause would support the Plan's goal to address extraordinary market volatility.¹³

On May 31, 2012, the Commission approved the Plan as a one-year pilot, which shall be implemented in two phases.¹⁴ The first phase of the Plan shall be implemented beginning April 8, 2013.¹⁵

III. Description of the Proposal

In light of and in connection with the Limit Up-Limit Down Plan, the Exchange is adopting Chapter V, Section 3(d)(iii) to provide that the Exchange shall exclude the amount of time an NMS stock underlying a NOM option is in a Limit State or Straddle State from the total amount of time in the trading day when calculating the percentage of the trading day Options Market Makers are required to quote.

¹³ As set forth in more detail in the Plan, all trading centers would be required to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for an NMS Stock. The Processors would be able to disseminate an offer below the Lower Price Band or bid above the Upper Price Band that nevertheless may be inadvertently submitted despite such reasonable policies and procedures, but with an appropriate flag identifying it as non-executable; such bid or offer would not be included in National Best Bid or National Best Offer calculations. In addition, all trading centers would be required to develop, maintain, and enforce policies and procedures reasonably designed to prevent trades at prices outside the price bands, with the exception of single-priced opening, reopening, and closing transactions on the Primary Listing Exchange.

¹⁴ See "Limit Up-Limit Down Plan," supra note 6. See also Securities Exchange Act Release No. 68953 (February 20, 2013), 78 FR 13113 (February 26, 2013) (Second Amendment to Limit Up-Limit Down Plan by BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Inc., et al.) and Securities Exchange Act Release No. 69062 (March 7, 2013), 78 FR 15757 (March 12, 2013) (Third Amendment to Limit Up-Limit Down Plan by BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Inc., et al.)

¹⁵ See "Second Amendment to Limit Up-Limit Down Plan," supra note 14.

Currently, under Chapter VII, Sections 5 and 6, NASDAQ requires Market Makers, on a daily basis, to make markets consistent with the applicable quoting requirements specified in Sections 5 and 6, on a continuous basis in at least 60% of the series in options in which the Market Maker is registered. To satisfy this requirement with respect to quoting a series, a Market Maker must quote such series 90% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as NASDAQ may announce in advance. The Exchange's proposal would suspend a Market Maker's continuous quoting obligation for the duration that an underlying NMS stock is in a Limit State or a Straddle State. As a result, when calculating the duration necessary for a Market Maker to meet its obligations that it post valid quotes at least 90% of the time the classes are open for trading, that time will not include the duration that the underlying is in a Limit State or Straddle State.

IV. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to a national securities exchange.¹⁶ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹⁷ which, among other things, requires a national securities exchange to be so organized and have the capacity to be able to carry out the purposes of the Act and to enforce compliance by its members and persons associated with its members with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange, and is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons

¹⁶ In approving the proposed rule changes, the Commission has considered their impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁷ 15 U.S.C. 78f(b).

engaged in regulation, 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.

The Commission finds that the proposal to suspend a Market Maker's obligations when the underlying security is in a limit up-limit down state is consistent with the Act. During a limit up-limit down state, there may not be a reliable price for the underlying security to serve as a benchmark for market makers to price options. In addition, the absence of an executable bid or offer for the underlying security will make it more difficult for market makers to hedge the purchase or sale of an option. Given these significant changes to the normal operating conditions of market makers, the Commission finds that the Exchange's decision to suspend a Market Maker's obligations in these limited circumstances is consistent with the Act.

The Commission notes, however, that the Plan was approved on a pilot basis and its Participants will monitor how it is functioning in the equity markets during the pilot period. To this end, the Commission expects that, upon implementation of the Plan, the Exchange will continue monitoring the quoting requirements that are being amended in this proposed rule change and determine if any necessary adjustments are required to ensure that they remain consistent with the Act.

The Commission also notes that the Exchange did not propose to waive its bid-ask spread requirements for Market Makers when the underlying is in a Limit or Straddle State. The Commission believes that retaining this requirement should help ensure the quality of the quotes that are entered and preserves one of the obligations of being a Market Maker.

In addition, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act¹⁸ for approving the proposed rule change on an accelerated basis. The proposal is related to the Plan, which will become operative on April 8, 2013.¹⁹ Without accelerated approval, the proposed rule change, and any attendant benefits, would take effect after the Plan's implementation date. Accordingly, the Commission finds that good cause exists for approving the proposed rule change on an accelerated basis.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act²⁰ that the

¹⁸ 15 U.S.C. 78s(b)(2)

¹⁹ See supra note 15.

²⁰ 15 U.S.C. 78f(b)(2).

proposed rule change (SR-NASDAQ-2013-043) is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²¹

Kevin M. O'Neill
Deputy Secretary

²¹ 17 CFR 200.30-3(a)(12).