

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-78246; File No. SR-NASDAQ-2016-067)

July 7, 2016

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Adopt Limit Order Protection

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 24, 2016, The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) 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 amend Nasdaq’s Rule 4757, entitled “Book Processing” to adopt a Limit Order Protection or “LOP” for members accessing the Nasdaq Market Center.

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaq.cchwallstreet.com>, at the principal office of the Exchange, 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, the Exchange 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

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

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

Item IV below. The Exchange 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 a new mechanism to protect against erroneous Limit Orders which are entered into the Nasdaq Market Center. Specifically, this new feature addresses risks to market participants of human error in entering Limit Orders at unintended prices. LOP would prevent certain Limit Orders from executing or being placed on the Order Book at prices outside pre-set standard limits. The System would reject those Limit Orders, rather than executing them automatically. The proposed LOP feature is similar to a risk feature which exists today on the NASDAQ Options Market LLC (“NOM”)<sup>3</sup> and is available for Options Participants.

The Exchange proposes to adopt a new feature, LOP for Limit Orders, which would reject Limit Orders back to the member when the order exceeds certain defined logic. Specifically, the LOP feature would prevent certain Limit Orders at prices outside of pre-set standard limits (“LOP Limit”) from being accepted by the System. LOP shall apply to all Quotes and Orders, including any modified Orders.<sup>4</sup> LOP would not apply to Market Orders, Market Maker Peg Orders<sup>5</sup> or Intermarket Sweep Orders (ISO).<sup>6</sup> A Market Maker Peg Order is

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<sup>3</sup> See NOM Rules at Chapter VI, Section 6(c) and Section 18.

<sup>4</sup> If an Order is modified, LOP will review the order anew and, if LOP is triggered, such modification will not take effect and the original order will be rejected.

<sup>5</sup> A “Market Maker Peg Order” is an Order Type designed to allow a Market Maker to maintain a continuous two-sided quotation at a displayed price that is compliant with the quotation requirements for Market Makers set forth in Rule 4613(a)(2). The displayed price of the Market Maker Peg Order is set with reference to a “Reference Price” in order to keep the displayed price of the Market Maker Peg Order within a bounded price range.

a passive order type which will not otherwise remove liquidity from the Order Book. This order type was designed to assist Market Makers with meeting their quoting obligations. Market Makers have a diverse business model as compared with other market participants. Excluding the Market Maker Peg Order from the LOP will assist Market Makers in meeting their quoting obligations. The Exchange believes that because Market Makers have other risk protections in place to prevent them from quoting outside of their financial means, the risk level for erroneous trades is not the same as with other market participants. Market Makers have more sophisticated infrastructures than other market participants and are able to manage their risk, particularly with quoting, utilizing other tools which may not be available to other market participants. An ISO is immediately executable within the Nasdaq Market Center against orders against which they are marketable. The ISO designation on an order presumes that the market participant has satisfied their obligation to all protected quotes up to the limit of the ISO.

LOP would be operational each trading day, except for orders designated for opening and closing crosses and initial public offerings. LOP would not be operational during trading halts and pauses. Since Nasdaq Rules provided controls for the opening, closing and initial public offering processes within the Rulebook, the proposed protections are rendered ineffective for

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A Market Maker Peg Order may be entered through RASH, FIX or QIX only. A Market Maker Peg Order must be entered with a limit price beyond which the Order may not be priced. The Reference Price for a Market Maker Peg Order to buy (sell) is the then-current National Best Bid (National Best Offer) (including Nasdaq), or if no such National Best Bid or National Best Offer, the most recent reported last-sale eligible trade from the responsible single plan processor for that day, or if none, the previous closing price of the security as adjusted to reflect any corporate actions (e.g., dividends or stock splits) in the security. See Nasdaq Rule 4702(b)(7).

<sup>6</sup> An Intermarket Sweep or ISO Order, which is an Order that is immediately executable within the Nasdaq Market Center against Orders against which they are marketable, is not subject to LOP. See NASDAQ Rule 4702. [sic]

those processes.<sup>7</sup> Members will be subject to certain parameters when submitting Limit Orders into the Order Book. Also, LOP would not apply in the event that there is no established LOP Reference Price.<sup>8</sup> The LOP Reference Price shall be the current National Best Bid or Best Offer (NBBO), the bid for sell orders and the offer for buy orders.

The Exchange proposes to not accept incoming Limit Orders that exceed the LOP Reference Threshold. Limit Orders will not be accepted if the price of the Limit Order is greater than the LOP Reference Threshold for a buy Limit Order. Limit Orders will not be accepted if the price of the Limit Order is less than the LOP Reference Threshold for a sell Limit Order. The LOP Reference Threshold for buy orders will be the LOP Reference Price (offer) plus the applicable percentage specified [sic] in the LOP Limit. The LOP Reference Threshold for sell orders will be the LOP Reference Price (bid) minus the applicable percentage specified [sic] in the LOP Limit. The LOP Limit shall be the greater of 10% of the LOP Reference Price or \$0.50 for all securities across all trading sessions. The LOP Reference Price shall be the current National Best Bid or Best Offer (NBBO), the bid for sell orders and the offer for buy orders.

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<sup>7</sup> The Nasdaq Rulebook provides specific rules for certain auction mechanisms, such as the opening, closing and initial public offering process which contain their own protections with respect to the entry of Orders within those mechanisms and therefore are not subject to LOP. With respect to the open, Nasdaq has a process, namely the “Nasdaq Opening Cross,” which shall occur at the price that maximizes the number of shares. See Rule 4752(a)(2)(F)(i) –(iii). [sic] With respect to the close, Nasdaq has a process, namely the “Nasdaq Closing Cross,” for determining the price at which orders shall be executed at the close and for executing those orders. See Rule 4754(b)(2)(e.) [sic] With respect to initial public offerings, the Exchange may halt trading in a security that is the subject of an Initial Public Offering. See Rule 4120(a)(7). The Exchange’s rules do not permit aberrant trading and require a security must pass the price validation. See Rule 4120(c)(8)(A).

<sup>8</sup> For example, if there is a one-sided quote or if the LOP Reference Price is less than the greater of 10% or \$0.50.

The Exchange also notes that LOP will be applicable on all protocols.<sup>9</sup> The LOP feature will be mandatory for all Nasdaq members. The Exchange proposes to implement this rule within ninety (90) days of the approval of this proposed rule change. The Exchange will issue an Equities Trader Alert in advance to inform market participants of such implementation date.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>10</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>11</sup> in particular, in that it is 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, by mitigating risks to market participants of human error in entering Limit Orders at clearly unintended prices. The proposals are appropriate and reasonable, because they offer protections for Limit Orders which should encourage price continuity and, in turn, protect investors and the public interest by reducing executions occurring at dislocated prices.

The proposed LOP feature would assist with the maintenance of fair and orderly markets by mitigating the risks associated with errors resulting in executions at prices that are away from the Best Bid or Offer and potentially erroneous. Further the proposal protects investors from potentially receiving executions away from the prevailing prices at any given time. The Exchange proposes LOP to avoid a series of improperly priced aggressive orders transacting in the Order Book. The LOP Limit is appropriate because it seeks to capture improperly priced

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<sup>9</sup> Nasdaq maintains several communications protocols for Participants to use in entering Orders and sending other messages to the Nasdaq Market Center, such as: OUCH, RASH, QIX, FLITE and FIX.

<sup>10</sup> 15 U.S.C. 78f(b).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

Limit Orders and reject them to reduce the risk of, and to potentially prevent, the automatic execution of Orders at prices that may be considered clearly erroneous. The System will only execute Limit Orders priced within the LOP Limit. The Exchange's proposed LOP Limit is a reasonable measure to ensure prices remain within the reasonable limits. This protection will bolster the normal resilience and market behavior that persistently produces robust reference prices. This feature should create a level of protection that prevents the Limit Orders from entering the Order Book outside of an acceptable range for the Limit Order to execute.

The LOP will reduce the negative impacts of sudden, unanticipated volatility, and serve to preserve an orderly market in a transparent and uniform manner, increase overall market confidence, and promote fair and orderly markets and the protection of investors. This feature is not optional and is applicable to all members submitting Limit Orders.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The LOP feature will provide market participants with additional price protection from anomalous executions. This feature is not optional and is applicable to all members submitting Limit Orders. Thus, the Exchange does not believe the proposal creates any significant impact on competition. This type of risk protection is in place today for NOM Options Participants.<sup>12</sup> Offering this protection to the Nasdaq Market Center will not impose any undue burden on intra-market competition, rather, it would permit equities and options members to be protected in a similar manner from erroneous executions.

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<sup>12</sup> See NOM Rules at Chapter VI, Section 6(c) and Section 18.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

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 up to 90 days (i) as the Commission may designate 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 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-NASDAQ-2016-067 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2016-067. 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 the 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 available publicly. All submissions should refer to File Number SR-NASDAQ-2016-067 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>13</sup>

Brent J. Fields  
Secretary

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<sup>13</sup> 17 CFR 200.30-3(a)(12).