

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-79876; File No. SR-NASDAQ-2016-131)

January 25, 2017

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Granting Approval of Proposed Rule Change, as Modified by Amendment Nos. 2 and 3, to Enhance the Reopening Auction Process Following a Trading Halt Declared Pursuant to the Plan to Address Extraordinary Market Volatility

I. Introduction

On October 13, 2016, The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) 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 a proposed rule change related to the Exchange’s re-opening process following a trading halt declared pursuant to the National Market System Plan to Address Extraordinary Market Volatility (“Plan”). The proposed rule change was published for comment in the Federal Register on November 1, 2016.³ On December 5, 2016, the Exchange filed Amendment No. 1 to the proposed rule change. On December 14, 2016, the Commission extended the time period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change to January 30, 2017.⁴ On December 21, 2016, the Exchange withdrew Amendment No. 1 and filed Amendment No. 2 to the proposed rule change. On January 19, 2017, the Exchange filed Amendment No. 3 to the proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 79158 (October 26, 2016), 81 FR 75879 (“Notice”).

⁴ See Securities Exchange Act Release No. 79551, 81 FR 92885 (December 20, 2016).

change.⁵ The Commission received no comments on the proposed rule change. This order approves the proposed rule change, as modified by Amendment Nos. 2 and 3.

II. Description of the Proposed Rule Change, as Modified by Amendment Nos. 2 and 3

In conjunction with the Twelfth Amendment to the Plan,⁶ the Exchange proposes to revise its re-opening process following a trading halt declared pursuant to the Plan (“Trading Pause”) and to make related changes.

Auction Reference Price and Auction Collar for the Re-Opening Process Following a Trading Pause

The Exchange proposes to establish an “Auction Reference Price” and an “Auction Collar” for the re-opening process following a Trading Pause. Specifically, for a Limit Down triggered pause, the Auction Reference Price would be the Lower Band price of the LULD Band in place at the time the Trading Pause was triggered.⁷ For a Limit Up triggered pause, the Auction Reference Price would be the Upper Band price of the LULD Band in place at the time

⁵ In Amendment No. 2, the Exchange proposed to use the Auction Reference Price to determine whether a security subject to a Trading Pause is priced at \$3 or less, which would determine the method of calculating the Auction Collars. The Exchange also made a conforming change to Nasdaq Rule 4754(b)(6) relating to Trading Pauses that exist at or after 3:50 p.m. In Amendment No. 3, the Exchange proposed to implement the proposed rule change in the third quarter of 2017, following the Commission’s approval of the Twelfth Amendment to the Plan. The Exchange also explained that this implementation is contingent on the Securities Information Processors successfully implementing changes to their systems to allow for the new re-opening process, and the other Primary Listing Exchanges gaining approval of their related filings and their ability to implement the changes concurrent with Nasdaq. Because Amendment Nos. 2 and 3 do not materially alter the substance of the proposed rule change or raise unique or novel regulatory issues, they are not subject to notice and comment. Both amendments are available at: <https://www.sec.gov/comments/sr-nasdaq-2016-131/nasdaq2016131.shtml>.

⁶ See Securities Exchange Act Release No. 79845 (January 19, 2017) (File No. 4-631).

⁷ See proposed Nasdaq Rule 4120(c)(10)(A)(i)(a).

the Trading Pause was triggered.⁸ With respect to Auction Collars, for a Limit Down triggered pause, the lower Auction Collar price would be derived by subtracting 5% of the Auction Reference Price, rounded to the nearest minimum price increment, or in the case of securities with an Auction Reference Price of \$3 or less, \$0.15, from the Auction Reference Price, and the upper Auction Collar price would be the Upper Band price of the LULD Band in place at the time the Trading Pause was triggered.⁹ For a Limit Up triggered pause, the upper Auction Collar price would be derived by adding 5% of the Auction Reference Price, rounded to the nearest minimum price increment, or in the case of securities with an Auction Reference Price of \$3 or less, \$0.15, to the Auction Reference Price, and the lower Auction Collar price would be the Lower Band price of the LULD Band in place at the time the Trading Pause was triggered.¹⁰

Extension of Re-Opening Time and Expansion of Auction Collars

As proposed, for any security listed on the Exchange, prior to terminating a Trading Pause, there would be a 5-minute “Initial Display Only Period” during which market participants may enter quotations and orders in that security in Nasdaq systems.¹¹ At the conclusion of the Initial Display Only Period, the security would be released for trading unless, at the end of the Initial Display Only Period, the Exchange detects an order imbalance in the security.¹² In that

⁸ See proposed Nasdaq Rule 4120(c)(10)(A)(i)(b). The proposed definition of Auction Reference Price for a Trading Pause is designed to be consistent across listing exchanges.

⁹ See proposed Nasdaq Rule 4120(c)(10)(A)(ii)(a).

¹⁰ See proposed Nasdaq Rule 4120(c)(10)(A)(ii)(b). The proposed Auction Collars for a Trading Pause are designed to be consistent across listing exchanges.

¹¹ See proposed Nasdaq Rule 4120(c)(10). The proposed rule would also provide that the Trading Pause shall be terminated when Nasdaq releases the security for trading. See *id.* The Exchange proposes a conforming change in Nasdaq Rule 4120(c)(7)(A).

¹² See proposed Nasdaq Rule 4120(c)(10)(B). According to proposed Nasdaq Rule 4120(c)(10)(E), upon completion of the cross calculation, an order imbalance shall be established as follows: (i) the calculated price at which the security would be released for trading is above (below) the upper (lower) Auction Collar price calculated under

case, the Exchange would extend the Display Only Period for an additional 5-minute period (“Extended Display Only Period”) and the Auction Collars would be adjusted.¹³ Specifically, If the Display Only Period is extended because the calculated price at which the security would be released for trading is below the lower Auction Collar price or all sell market orders would not be executed in the cross, then the new lower Auction Collar price would be derived by subtracting 5% of the initial Auction Reference Price, which was rounded to the nearest minimum price increment, or in the case of securities with an Auction Reference Price of \$3 or less, \$0.15, from the previous lower Auction Collar price, and the upper Auction Collar price would not be changed.¹⁴ If the Display Only Period is extended because the calculated price at which the security would be released for trading is above the upper Auction Collar price or all buy market orders would not be executed in the cross, then the new upper Auction Collar price would be derived by adding 5% of the initial Auction Reference Price, which was rounded to the nearest minimum price increment, or in the case of securities with an Auction Reference Price of \$3 or less, \$0.15, to the previous upper Auction Collar price, and the lower Auction Collar price would not be changed.¹⁵

At the conclusion of the Extended Display Only Period, the security would be released for trading unless, at the end of the Extended Display Only Period, the Exchange detects an order imbalance in the security.¹⁶ In that case, the Exchange would further extend the Display Only Period and continue to adjust the Auction Collar prices every five minutes in the manner

paragraphs (A), (B), or (C) of Nasdaq Rule 4120(c)(10); or (ii) all market orders would not be executed in the cross.

¹³ See proposed Nasdaq Rule 4120(c)(10)(B).

¹⁴ See proposed Nasdaq Rule 4120(c)(10)(B)(i).

¹⁵ See proposed Nasdaq Rule 4120(c)(10)(B)(ii).

¹⁶ See proposed Nasdaq Rule 4120(c)(10)(C).

described in proposed Nasdaq Rule 4120(c)(10)(B) until the security is released for trading.¹⁷

With respect to these additional extensions, the Exchange would release the security for trading at the first point there is no order imbalance.¹⁸

As proposed, if a Trading Pause for a security exists at or after 3:50 p.m., the Exchange would conduct a LULD Closing Cross pursuant to Nasdaq Rule 4754(b)(6).¹⁹

Other Changes Related to the Re-Opening Process Following a Trading Pause

Nasdaq Rule 4753(a)(3) currently defines “Order Imbalance Indicator” to mean a message disseminated by electronic means containing information about Eligible Interest and the price at which such interest would execute at the time of dissemination. The Exchange proposes to add that, for purposes of a Trading Pause initiated pursuant to Nasdaq Rule 4120(a)(12), “Order Imbalance Indicator” would also include Auction Reference Prices and Auction Collars, as defined in proposed Nasdaq Rule 4120(c)(10)(A).²⁰

The Exchange also proposes to amend Nasdaq Rule 11890 to provide that executions as a result of a Halt Auction under Nasdaq Rule 4120(c)(10) would not be eligible for a request to review as clearly erroneous under Nasdaq Rule 11890.²¹

Other Changes Relating to Trading Pauses

¹⁷ See id.

¹⁸ See id. The proposed extensions and widening of the Auction Collars are designed to be consistent across listing exchanges.

¹⁹ See proposed Nasdaq Rule 4120(a)(10)(D). The Exchange also proposes conforming changes to Nasdaq Rules 4120(a)(12)(H) and 4754(b)(6). The concept of holding a closing auction instead of a re-opening auction if a Trading Pause exists in the last ten minutes of trading is designed to be consistent across listing exchanges and to reflect the Twelfth Amendment to the Plan.

²⁰ See proposed Nasdaq Rule 4753(a)(3)(F).

²¹ The proposal to exclude re-opening auction trades from the clearly erroneous execution rule is designed to be consistent across listing exchanges.

The Exchange proposes to amend Nasdaq Rule 4120(a)(12)(G) to state that if the Exchange is unable to re-open trading due to a systems or technology issue, it shall notify the Processor immediately.²² The Exchange also proposes to amend Nasdaq Rule 4120(a)(12)(H) to state that if a Trading Pause was initiated by another exchange, the Exchange may resume trading only upon receipt of Price Bands from the Processor.²³

The Exchange proposes to implement this proposed rule change in the third quarter of 2017.²⁴ The Exchange represents that it will announce the implementation date of this proposed rule change via a notice to be issued after this proposed rule change is approved by the Commission.²⁵

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendment Nos. 2 and 3, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.²⁶ In particular, the

²² See proposed Nasdaq Rule 4120(a)(12)(G). This change is designed to be consistent across listing exchanges and to reflect the Twelfth Amendment to the Plan. The Exchange also proposes to delete rule text in Nasdaq Rule 4120(a)(12)(G) concerning phased implementation of the Plan, because the Plan has been fully implemented.

²³ See proposed Nasdaq Rule 4120(a)(12)(H). This change is designed to be consistent across listing exchanges and to reflect the Twelfth Amendment to the Plan.

²⁴ The Exchange explains that implementation of the proposed changes is contingent on the Securities Information Processors successfully implementing changes to their systems to allow for the new re-opening process, and the other Primary Listing Exchanges gaining approval of their related filings and their ability to implement the changes concurrent with Nasdaq. See Amendment No. 3, supra note 5.

²⁵ See id. For a more detailed description of the proposed rule change, see Notice, supra note 3.

²⁶ 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).

Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,²⁷ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in 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. As noted above, the Commission received no comment letters regarding the proposed rule change.

The Commission notes that the proposed rule change is designed, together with the Twelfth Amendment to the Plan,²⁸ to address the issues experienced on August 24, 2015 by reducing the number of repeat Trading Pauses in a single NMS Stock.²⁹ The Commission notes that the proposed rule change is also designed to further the goal of establishing a standardized approach for how Primary Listing Exchanges would conduct certain aspects of an automated re-opening following a Trading Pause, which should provide certainty for market participants regarding how a security would re-open following a Trading Pause, regardless of the listing exchange.³⁰

With respect to the proposed Auction Reference Price and Auction Collars, the Commission finds reasonable the Exchange's belief that the price of the limit state that preceded the Trading Pause (i.e., either the Lower or Upper Price Band price) would better reflect the most

²⁷ 15 U.S.C. 78f(b)(5).

²⁸ See supra note 6.

²⁹ See Notice, supra note 3, at 75882.

³⁰ See id.

recent price of the security, and therefore should be used as the Auction Reference Price.³¹

Moreover, the Commission believes that the proposed method for calculating the initial Auction Collars (i.e., the Auction Collar on the opposite side of the trading pressure would be the Price Band in place before the Trading Pause was triggered) would address the concept of mean reversion, as well as avoid a security from trading outside of a price that it would have been permitted to trade before the Trading Pause.³²

The Commission believes that extending the Trading Pause and widening the Auction Collar on the side of the order imbalance would be a measured approach to provide additional time to attract offsetting interest, to help to address an imbalance that may not be resolved within the prior Auction Collars, and to reduce the potential for triggering another Trading Pause.³³ Also, as the Exchange noted, widening the Auction Collar only in the direction of the order imbalance would address issues relating to the concept of mean reversion.³⁴ Moreover, the Commission notes that the proposal to conduct a LULD Closing Cross pursuant to Nasdaq Rule 4754(b)(6) should a Trading Pause exist at or after 3:50 p.m. would be consistent with the Twelfth Amendment to the Plan.

The Commission believes that it is appropriate to preclude requests to review executions as a result of a Halt Auction under Nasdaq Rule 4120(c)(10) as clearly erroneous. The Commission notes that the proposed re-opening procedures would allow for widened collars, which may result in a re-opening price that would be away from prior trading prices, but the re-

³¹ See Notice, supra note 3, at 75882-83.

³² See Notice, supra note 3, at 75883.

³³ See Notice, supra note 3, at 75882.

³⁴ See Notice, supra note 3, at 75883.

opening price would be the result of a measured and transparent process that reduces the potential that such a trade would be considered erroneous.³⁵

The Commission believes that the proposed enhancements to the Order Imbalance Indicator would further promote transparency around the re-opening process following a Trading Pause.

Finally, the Commission notes that the proposed amendments to Nasdaq Rule 4210(a)(12)(G) and (H) would remove obsolete rule text and conform the remaining rule text to the Twelfth Amendment to the Plan.

Based on the Exchange's representations mentioned above and in the Notice, and for the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment Nos. 2 and 3, is consistent with Section 6(b)(5) of the Act³⁶ and the rules and regulations thereunder applicable to a national securities exchange.

³⁵ See id.

³⁶ 15 U.S.C. 78f(b)(5).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³⁷ that the proposed rule change (SR-NASDAQ-2016-131), as modified by Amendment Nos. 2 and 3, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁸

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Assistant Secretary

³⁷ 15 U.S.C. 78s(b)(2).

³⁸ 17 CFR 200.30-3(a)(12).