

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-61276; File No. SR-NYSEAmex-2009-82)

January 4, 2010

Self-Regulatory Organizations; NYSE Amex LLC; Order Approving a Proposed Rule Change Rescinding NYSE Information Memoranda 04-27 and 07-66 and Issuing a New Information Memo Concerning the Exchange's Gap Quote Policy

I. Introduction

On November 9, 2009, the NYSE Amex LLC ("NYSEAmex" or the "Exchange") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change to rescind NYSE Information Memoranda 04-27 and 07-66 and issue a new Information Memo that provides updated parameters for, and guidance on the application of, the Exchange's Gap Quote Policy (the "Policy"). In order to ensure an orderly transition to usage of the new parameters, the Exchange has proposed that these changes be made operative ten business days after the date of this order. The proposed rule change was published for comment in the Federal Register on December 1, 2009.<sup>3</sup> The Commission received no comment letters on the proposal. This order approves the proposed rule change.

II. Description of the Proposal<sup>4</sup>

The purpose of the Policy is to provide public notice of order imbalances for securities, facilitate price discovery, and minimize short-term price dislocation, by allowing for the entry of offsetting orders or the cancellation of orders on the side of an imbalance.

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

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

<sup>3</sup> See Securities Exchange Act Release No. 61049 (November 23, 2009), 74 FR 62851 ("Notice").

<sup>4</sup> For a full description of the proposal, including an overview of the history of the Policy and a detailed description of the current terms of the Policy, see id.

An order imbalance may occur when the Exchange receives a sudden influx of orders for a particular security on the same side of the market within a short time interval, or when one or more large-size orders for a security are entered, and there is insufficient offsetting interest. When an imbalance exists that the Designated Market Maker (“DMM”) determines would cause a significant price dislocation, the Policy provides that the DMM should widen the spread between the bid and offer—a process known as “gapping the quote.” The use of a gap quote signals the existence of the imbalance to the market in order to attract contra-side liquidity and mitigate volatility.

The proposed Information Memo includes a summary of the options available to a DMM when publishing a gap quote. In this situation, a DMM may: (1) trade out of the gap quote by executing contra side interest against the imbalance (allowing for any cancellations); (2) update the gap quote, in consultation with a senior-level Floor Official; or (3) request an order imbalance trading halt in the security at issue, in consultation with a senior-level Floor Official.

Under the proposal, the volume requirement for implementing a gap quote would be reduced from at least 10,000 shares to at least 5,000 shares, and the value requirement for implementing a gap quote would be reduced from \$200,000 or more to \$100,000 or more. If either requirement is met, the DMM may implement a gap quote if it determines the imbalance would cause a significant price dislocation. In addition, the Exchange has proposed to clarify the factors DMMs consider when setting the price of the gap quote. Finally, the Exchange has proposed to clarify certain aspects of the Policy and make other technical or non-substantive changes.

A. Reduced Minimum Size and Value Requirements

The Exchange has proposed to reduce the minimum size and value requirements for the use of a gap quote under the Policy to at least 5,000 shares or a market value of \$100,000 or more. The Exchange believes that these lower thresholds better reflect current market conditions. In addition to reducing the quantitative requirements for implementing a gap quote, the Exchange has proposed to add language clarifying that, notwithstanding meeting the minimum size or value requirement, an imbalance must also be anticipated to cause a significant price dislocation in the stock at issue in order to justify a gap quote. The Exchange believes it is important to emphasize that whether a gap quote is appropriate depends on the characteristics of a security as much as on the Policy's minimum requirements.

B. Setting the Price of the Gap Quote

The current Information Memo instructs DMMs to set the price of a gap quote "at the price at which the DMM believes the stock would trade if no contra side interest developed or no cancellations occurred[.]" The Exchange has instead proposed that the DMM should publish the gap quote at the price where the DMM "reasonably anticipates" the stock would trade if no contra side interest developed or no cancellations occurred, which the Exchange believes helps clarify the guidance.

The Exchange has also proposed to clarify that the Policy still requires a DMM to take into account, "to the extent known," executable orders, e-Quotes and verbal interest in the Crowd (on the side of the market opposite the imbalance) at prices better than the price set by the DMM as the side of the gap quote opposite the imbalance when making his or her pricing determination. If the imbalance is known to be limited as to price, the DMM should not set the gap quote higher than that limit price.

The Exchange also has proposed to add a provision reminding the DMMs that, at the time they publish a gap quote, they should set the price of the gap quote such that it is likely to result in a trade of at least the minimum size of 5,000 shares or \$100,000 in value, thus clearing all, or a substantial portion of, the imbalance.

C. Other Clarifications and Technical or Non-substantive Changes

The Exchange has also proposed several additional changes. A complete list of these changes is set forth in the Notice.<sup>5</sup> Among these changes are the following:

- The Exchange has proposed to add language to the Information Memo clarifying the DMM's responsibilities when implementing a gap quote. DMMs must balance the need for accurate price discovery with the need to attract contra side interest and trade out of the gap quote as soon as possible. In doing so, the DMM should, in consultation with a senior-level Floor Official, consider updating the gap quote after initial publication if doing so is necessary to attract sufficient contra side interest.
- The Exchange has proposed to add language reminding members and member organizations that the gap quote procedures may not be initiated after trading has closed. Instead, where there is a significant imbalance in a security at the close of trading, members and member organizations should use the procedures provided under NYSE Amex Equities Rule 123C(8) when attempting to mitigate the imbalance.
- The Information Memo currently includes an example illustrating implementation of a gap quote following an influx of orders from the Floor. The Exchange has

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<sup>5</sup> See id. at 62853-54.

proposed to add an example to the Information Memo which illustrates how the Policy works when the imbalance results in a liquidity replenishment point being reached.<sup>6</sup>

- Finally, because DMMs no longer act as agent for orders on the Display Book under the rules of the Exchange's New Market Model,<sup>7</sup> the proposed Information Memo would clarify that a DMM who fails to follow the Policy would not be in violation the Order Display rule<sup>8</sup> and/or the Firm Quote rule<sup>9</sup> under Regulation NMS, but could be liable under NYSE Amex Equities Rules for a failure to maintain a fair and orderly market or a failure to observe high standards of commercial honor and just and equitable principles of trade.<sup>10</sup>

### III. Discussion and Commission Findings

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>11</sup> In particular, it is consistent with Section 6(b)(5) of the Act,<sup>12</sup> which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable

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<sup>6</sup> See NYSE Amex Equities Rule 1000(a)(iv).

<sup>7</sup> In October 2008, the Commission approved The New York Stock Exchange's proposal to eliminate specialists and introduce DMMs. See Securities Exchange Act Release No. 58845 (October 24, 2008), 73 FR 64379 (October 29, 2008) (SR-NYSE-2008-46). NYSE Amex adopted NYSE's trading rules, including the rules regarding DMMs and the New Market Model, in November 2008. See Securities Exchange Act Release No. 59022 (November 26, 2008), 73 FR 73683 (December 3, 2008) (SR-NYSEALTR-2008-10).

<sup>8</sup> See 17 CFR 242.604.

<sup>9</sup> See 17 CFR 242.602.

<sup>10</sup> See NYSE Amex Equities Rules 104(a), 104(f) and 2010.

<sup>11</sup> 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).

<sup>12</sup> 15 U.S.C. 78f(b)(5).

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. The proposed rule change also supports the principles of Section 11A(a)(1)<sup>13</sup> of the Act in that it seeks to ensure the economically efficient execution of securities transactions and fair competition among brokers and dealers and among exchange markets.

The Exchange stated in the proposal that it believes the current volume and value requirements are too high in light of current market conditions. Recent trends in market activity have driven down both average trade sizes and average stock prices. As a result, the current volume and value requirements are met less frequently than they once were, and there are fewer occasions on which a DMM may use gap quotes to facilitate price discovery and minimize short-term price dislocation. The Exchange stated in its proposal that, based on its analysis of historical market conditions, the proposal to lower the gap quote volume and value requirements will permit an increased use of gap quotes, which it believed would be appropriate for current market conditions. In addition, the Exchange did not believe that lowering the requirements would cause an increase in the use of gap quotes to such a degree that would negatively impact the quality of the Exchange's market. The revised volume and value requirements should provide greater transparency and efficiency and additional reductions in volatility, consistent with the purpose of the Policy.

The Commission believes that the remaining aspects of the proposed rule change set forth in the Notice are either technical or non-substantive in nature, or are clarifications of the existing gap quote policy, and therefore are consistent with the Act.

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<sup>13</sup> 15 U.S.C. 78k-1(a)(1).

The Commission notes that the Exchange represented in the Notice that it has reasonable policies and procedures to surveil DMMs' use of gap quotes and to detect the potential misuse of gap quotes in violation of Exchange rules and federal securities laws. Such surveillance should provide the Exchange with information that will be helpful in assessing the effects of an increased number of gap quotes on the Exchange's market.

In light of the foregoing, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-NYSEAmex-2009-82) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> 17 CFR 200.30-3(a)(12).