

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-67085; File No. SR-FINRA-2012-026)

May 31, 2012

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to the Handling of Stop and Stop Limit Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 24, 2012, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. 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

FINRA is proposing to amend FINRA’s rules relating to the handling of stop and stop limit orders.

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA 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, FINRA 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 Item IV

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

below. FINRA 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

FINRA Rule 6140(h) addresses the handling of stop orders in NMS stocks.³ Specifically, the Rule provides that a member may, but is not obligated to, accept a stop order in a designated security.⁴ The Rule further provides that a stop order becomes a market order (or a stop limit order becomes a limit order) when a transaction takes place at or above the stop price (in the case of a buy stop order) or at or below the stop price (in the case of a sell stop order).⁵

Although Rule 6140(h) provides that a stop order is triggered by a transaction, FINRA understands that certain firms and their customers prefer alternative triggers for activating a stop or stop limit order. For example, some members have noted that using quotations may be preferable because, for some securities, quotations serve as a better indicator of the current price than transactions. Thinly traded securities (e.g., certain exchange-traded funds) have limited trading during the trading day, although quotations may be continuously updated and would serve as the better indicator of the current market price for these securities. As such, investors in these securities may prefer that their stop order be monitored against quotations instead of

³ The requirements in Rule 6140(h) were initially adopted by NASD (and the national securities exchanges) in 1975. See Notice to Members 75-42 (June 10, 1975) (Rules Governing Reporting of Transactions to Consolidated Tape).

⁴ Rule 6140(a) defines a "designated security" as any NMS stock as defined in Rule 600(b)(47) of SEC Regulation NMS.

⁵ Stop buy orders generally are entered by investors with short positions to limit losses should the stock price increase. Stop sell orders generally are entered in a stock whose price has increased substantially in order to protect the investor's profits should the stock price decline.

waiting for trades. Conversely, some members have indicated that customers could be disadvantaged by the triggering of a stop order on a quotation because doing so may result in an execution at a price that the stock had never traded at that day – an outcome that may be considered undesirable for an investor placing a stop order.⁶

FINRA believes that, given the various risks and benefits of each triggering event, members and their customers should be permitted to consider these factors and determine which order type (and trigger) is appropriate. In this regard, FINRA previously proposed amendments to the Rule 6140(h) to delete the requirement that transactions at the stop price serve as the only triggering event for stop orders, thereby providing members and customers with the flexibility to tailor their order types. However, this proposal was not approved by the Commission based on concerns that the proposed rule did not promote the ability of investors to understand the key attributes of the order and make an informed choice as to whether to use a particular type of order.⁷

In light of the Commission’s concerns, FINRA is proposing Rule 5350(a), which would retain the current transaction-based trigger for activating stop and stop limit orders and provide all investors placing a “stop order” or a “stop limit order” with certainty that their order will only be activated by a transaction at the stop price. At the same time, proposed Supplementary Material .01 to the rule would permit members to offer an alternative trigger to activate an order as a market or limit order, so long as such alternative order type is not labeled as a “stop order”

⁶ Other concerns with using quotations include that quotations may be more vulnerable to abuse because they can be manipulated to trigger stops and then withdrawn/changed. However, other members note that using transactions also could result in the improper triggering of a customer’s stop order due to trades at prices outside of the current market – whether intentional or erroneous trades.

⁷ See Securities Exchange Act Release No. 63885 (February 10, 2011), 76 FR 9062 (February 16, 2011) (Order Disapproving File No. SR-FINRA-2010-055).

or a “stop limit order” and is clearly distinguishable from a stop or stop limit order (e.g., an alternative order type that triggers using a quotation at the stop price may be labeled a “stop quotation order”).⁸ In cases where the member offers an alternative order type that activates as a market or limit order using an event other than a transaction at the stop price, the member must disclose to the customer, in paper or electronic form, prior to the time the customer places the order (e.g., at account opening), a description of the order type including the triggering event.⁹

FINRA believes that, by requiring that alternative-trigger order types be labeled something other than a “stop” or “stop limit” order and be clearly distinguishable from a stop or stop limit order, members and customers will share a uniform understanding as to what will serve as the triggering event for “stop orders.” To complement this approach, proposed Supplementary Material .02 to Rule 5350 also would require that, to the extent a member routes a customer stop or stop limit order to another broker-dealer or exchange for handling or execution, the member must take reasonable steps to ensure that the order is handled or executed by the other broker-dealer or exchange in accordance with Rule 5350(a). Similarly, a member that routes to another broker-dealer or exchange other order types using an alternative trigger in accordance with Supplementary Material .01 must take reasonable steps to ensure that the order is handled or executed by the other broker-dealer or exchange in accordance with the terms of the order as communicated to the customer placing the order.

⁸ The proposed rule would not apply to “not held” orders. See proposed Rule 5350(b). Generally, a “not held” order is an un-priced, discretionary order voluntarily categorized as such by the customer. As such, because the customer has given the member price and time discretion, the proposed requirements would not apply to a “not held” stop or stop limit order.

⁹ A member that permits customers to engage in securities transactions online also must post the required disclosures on the member’s website in a clear and conspicuous manner.

Finally, the stop order definition is being relocated from Rule 6140(h) to new Rule 5350 to ensure that the existing and proposed stop order provisions apply uniformly to both OTC Equity Securities¹⁰ and NMS stocks.

FINRA will announce the implementation date of the proposed rule change no later than 60 days following Commission approval. The implementation date will be no more than 150 days following Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹¹ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect investors and the public interest. FINRA believes that adopting the proposed rule change will provide customers with certainty as to how their stop orders will be treated, while also providing members with the flexibility to determine whether offering additional order types with alternative triggers are appropriate for their business and customer base, without compromising investor protection.

FINRA believes that the proposed rule change advances the protection of investors and the public interest in that it would further a more uniform definition of “stop order” and “stop limit order” for all equity securities, thereby providing investors with certainty as to the handling of such orders by their broker-dealers. In addition, FINRA believes that the proposed changes will promote just and equitable principles of trade by providing customers and members with the

¹⁰ FINRA Rule 6420(e) defines “OTC Equity Security” as any equity security that is not an “NMS stock” as that term is defined in Rule 600(b)(47) of SEC Regulation NMS; provided, however, that the term “OTC Equity Security” shall not include any Restricted Equity Security.

¹¹ 15 U.S.C. 78o-3(b)(6).

flexibility to select and offer other triggering events for alternative order types in accordance with their investment objectives and business models, while requiring members to disclose a description of the order type, including the triggering event, prior to the time the customer places the order.

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

FINRA does not believe that the proposed rule change will result in 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

Written comments were neither solicited nor 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 (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 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. Please include File Number SR-FINRA-2012-026 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-FINRA-2012-026. 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 FINRA. 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-FINRA-2012-026, 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.¹²

Kevin M. O'Neill
Deputy Secretary

¹² 17 CFR 200.30-3(a)(12).