

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-63255; File Nos. SR-BATS-2010-025; SR-BX-2010-66; SR-CBOE-2010-087; SR-CHX-2010-22; SR-FINRA-2010-049; SR-NASDAQ-2010-115; SR-NSX-2010-12; SR-NYSE-2010-69; SR-NYSEAmex-2010-96; SR-NYSEArca-2010-83)

November 5, 2010

Self-Regulatory Organizations; BATS Exchange, Inc.; NASDAQ OMX BX, Inc.; Chicago Board Options Exchange, Incorporated; The Chicago Stock Exchange, Inc.; Financial Industry Regulatory Authority, Inc.; The NASDAQ Stock Market LLC; National Stock Exchange, Inc.; New York Stock Exchange LLC; NYSE Amex LLC; NYSE Arca, Inc.; Order Granting Accelerated Approval to Proposed Rule Changes, as Modified by Amendment No. 1, to Enhance the Quotation Standards for Market Makers

I. Introduction

On September 17, 2010, each of BATS Exchange, Inc. (“BATS”), NASDAQ OMX BX, Inc. (“BX”), Chicago Board Options Exchange, Incorporated (“CBOE”), The Chicago Stock Exchange, Inc. (“CHX”), The NASDAQ Stock Market LLC (“Nasdaq”), New York Stock Exchange LLC (“NYSE”), National Stock Exchange, Inc. (“NSX”); NYSE Amex LLC (“NYSE Amex”); NYSE Arca, Inc. (“NYSE Arca”), and the Financial Industry Regulatory Authority, Inc. (“FINRA,” and together with BATS, BX, CBOE, CHX, Nasdaq, NYSE, NSX, NYSE Amex and NYSE Arca, the “SROs”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (“Act”), and Rule 19b-4 thereunder,² proposed rule changes to amend certain of their respective rules to enhance minimum quoting standards for market makers registered with the exchange or, in the case of FINRA, market makers that quote on the Alternative Display Facility (“ADF”). The purpose of these rule changes is to require equity market makers to post continuous two-sided quotations within a designated percentage of the inside market to eliminate market maker “stub

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

quotes,” that are so far away from the prevailing market that they are not intended to be executed (such as an order to buy at a penny or sell at \$100,000).

The proposed rule changes were published for comment in the Federal Register on September 24 and September 27, 2010.³ In addition, each of the SROs filed an Amendment No. 1 to their respective proposed rule changes.⁴ The Commission received no comments on the proposed rule changes. This order approves the proposed rule changes on an accelerated basis.

³ See Securities Exchange Act Release Nos. 62945 (September 20, 2010), 75 FR 58460 (September 24, 2010) (SR-BATS-2010-025); 62954 (September 20, 2010), 75 FR 59305 (September 27, 2010) (SR-BX-2010-66); 62951 (September 20, 2010), 75 FR 59309 (September 27, 2010) (SR-CBOE-2010-087); 62949 (September 20, 2010), 75 FR 59315 (September 27, 2010) (SR-CHX-2010-22); 62953 (September 20, 2010), 75 FR 59300 (September 27, 2010) (SR-FINRA-2010-049); 62950 (September 20, 2010), 75 FR 59311 (September 27, 2010) (SR-NASDAQ-2010-115); 62952 (September 20, 2010), 75 FR 59316 (September 27, 2010) (SR-NSX-2010-12); 62948 (September 20, 2010), 75 FR 58455 (September 24, 2010) (SR-NYSE-2010-69); 62947 (September 20, 2010), 75 FR 58453 (September 24, 2010) (SR-NYSEAmex-2010-96); 62946 (September 20, 2010), 75 FR 58462 (September 24, 2010) (SR-NYSEArca-2010-83).

⁴ The SROs filed their respective Amendments No. 1 on November 4, 2010. Each of the Amendments No. 1 modifies the proposals so that a market maker is not expected to enter a quote based on the prior day’s last sale at the commencement of regular trading hours if there is no National Best Bid (“NBB”) or National Best Offer (“NBO”). As amended, in such a circumstance, the quoting obligation would commence as soon as there has been a regular-way transaction on the primary listing market in the security, as reported by the responsible single plan processor. In addition, the Amendment modifies the proposals so that a market maker’s quoting obligations shall be suspended during a trading halt, suspension or pause, and shall not re-commence until after the first regular-way transaction on the primary listing market following that halt, suspension or pause, as reported by the responsible single plan processor. Finally, so that the markets may coordinate implementation upon approval of the proposed rule changes, in Amendment No. 1 the SROs stated that the planned implementation date for the proposed rule changes would be December 6, 2010.

II. Description of the Proposals

On May 6, 2010, the U.S. equity markets experienced a severe disruption.⁵

Among other things, the prices of a large number of individual securities suddenly declined by significant amounts in a very short time period, before suddenly reversing to prices consistent with their pre-decline levels. This severe price volatility led to a large number of trades being executed at temporarily depressed prices, including many that were more than 60% away from pre-decline prices and subsequently broken.

As noted in the May 6 Staff Report, executions against stub quotes represented a significant proportion of broken trades on May 6. To address this aspect of the events of May 6, in coordination with the Commission, the SROs filed proposals to address stub quotes by introducing minimum quoting standards for market makers.⁶ The proposals require market makers to maintain continuous two-sided quotations throughout the trading day⁷ that are within a certain percentage band of the national best bid and offer (“NBBO”). These requirements apply to all NMS stocks⁸ during normal market hours.

⁵ The events of May 6 are described more fully in the report of the staffs of the Commodity Futures Trading Commission (“CFTC”) and the Commission, titled 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 September 30, 2010 (“May 6 Staff Report”).

⁶ See supra note 3.

⁷ As noted, Amendment No. 1 modifies the proposals so that the quoting obligation would commence as soon as there has been a regular-way transaction on the primary listing market in the security, as reported by the responsible single plan processor. The Amendment also modifies that the market maker’s quoting obligations shall be suspended during a trading halt, suspension or pause, and shall not re-commence until the first-regular way print on the primary listing market following that halt, suspension or pause, as reported by the responsible single plan processor. See supra note 4.

⁸ See 17 CFR 242.600 (defining NMS stock as “any NMS security other than an option” and NMS security as “any security or class of securities for which

For stocks subject to the individual stock circuit breaker pilot program (i.e., stocks that are included in the S&P 500, stocks that are included in the Russell 1000, and certain exchange-traded products),⁹ market makers must enter quotes that are not more than 8% away from the NBBO. A quote that is entered at or within 8% away from the NBBO is allowed to drift a certain additional amount away from the NBBO before it must be adjusted by the market maker. However, if the NBBO moves to a point such that the quote is 9.5% away from the NBBO, that quote must be adjusted so that it is no further than 8% away from the NBBO. During times in which a single-stock circuit breaker is not applicable (i.e., before 9:45 a.m. and after 3:35 p.m.), market makers for such securities must maintain a quote no further than 20% away from the NBBO. Similar to the requirements when the single-stock circuit breakers are in effect, a market maker's quote may drift an additional 1.5% away from the NBBO without adjustment (i.e., until it is 21.5% away from the NBBO), at which point it would need to be adjusted to a quote no further than 20% away from the NBBO. In the absence of an NBBO, the same percentages apply, but the market maker must use the consolidated last sale instead of the NBBO.

For securities that are not subject to the single-stock circuit breakers, market makers must maintain quotes that are no more than 30% away from the NBBO. Like securities subject to the single-stock circuit breakers, if the NBBO moves to a point such

transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options”).

⁹ See Securities Exchange Act Release Nos. 62283 (September 10, 2010), 75 FR 56608 (September 16, 2010); 62884 (September 10, 2010), 75 FR 56618 (September 16, 2010).

that the quote is 31.5% away from the NBBO, the quote must be adjusted to a quote no further than 30% away from the NBBO.

Nothing in the proposals precludes a market maker from voluntarily quoting at price levels that are closer to the NBBO than required under the proposals.

The planned implementation date for the proposed rule changes is December 6, 2010.

As part of their rule proposals, certain SROs proposed additional amendments to conform their rules to those of the other SROs with respect to these market maker obligations. For example, FINRA proposed to amend its rule to explicitly state that the duties of a market maker include assisting in the maintenance of fair and orderly markets, while NYSE and NYSE Amex proposed to amend their respective rules to explicitly state that the duties of a market maker include maintaining a continuous two-sided quote with a displayed size of at least one round lot.

In addition, BATS, BX and Nasdaq proposed functionalities to automatically update market makers' quotes on their exchanges. Under the BATS proposal, such functionality would be optional. Upon the request of a market maker, the BATS system would automatically enter and adjust quotes in accordance with the proposed quotation requirements. If a market maker cancelled the quotations entered by BATS through this functionality, the market maker would remain responsible for complying with the minimum quotation requirements imposed by the new rule.

For both BX and Nasdaq, the exchange would automatically create a quote to comply with the proposed quoting requirements for each issue in which a market maker is registered. BX and Nasdaq would adjust one of these automated quotations when it

drifts to within 4% of the NBBO (or, if greater, one-quarter of the applicable percentage necessary to trigger an individual stock trading pause), or if the quote drifts to within the applicable percentage necessary to trigger an individual stock trading pause less 0.5%. If this occurs, BX or Nasdaq would adjust and display a quotation for the market maker at the appropriate percentage away from the NBBO. Other quotations directly entered by market makers would be allowed to move freely towards the NBBO for potential execution. If a quotation automatically entered by BX or Nasdaq on behalf of a market maker is executed, BX or Nasdaq would refresh the market maker's quote on the executed side of the market at the applicable percentage away from the NBBO or, if there is no NBBO, the last reported sale.

Finally, NYSE Arca proposed making conforming changes to its Q Order type. Specifically, NYSE Arca proposed to eliminate the "standard Q," an order that has a price of \$0.01 for the bid and two times the previous day's close for the offer, as an available order type. NYSE Arca also proposed to add to its Rule 7.31(k) that, to the extent that other types of Q Order functionality remain, nothing in the rule relating to Q Orders would be construed to relieve market makers of their obligations under the revised NYSE Arca Rule 7.23, which includes the proposed market maker quoting obligations.¹⁰

¹⁰ NYSE Arca has represented that it will separately file a proposed rule change to delete the text of Rule 7.31(k)(1)(B)(1), which states that a "Q Order entered with reserve size . . . will automatically repost with the original display size and \$10 below the original bid or \$10 above the original offer, but never below \$0.01," and to remove the accompanying Q Order functionality. The proposed date of implementation for this change will be December 6, consistent with the implementation date for the new market maker quoting requirements. See e-mail from Clare F. Saperstein, Vice President, Regulatory Policy and Management, NYSE Regulation, Inc., to David Liu, Senior Special Counsel, and Andrew Madar, Special Counsel, Commission, dated November 5, 2010.

III. Commission Findings

The Commission finds that the proposed rule changes implementing enhanced market maker quotation standards are consistent with the requirements of the Act and the rules and regulations thereunder applicable to national securities exchanges and national securities associations. In particular, with respect to the proposals submitted by the national securities exchanges, the Commission finds that the proposals are consistent with Section 6(b)(5) of the Act,¹¹ which, among other things, requires that the rules of national securities exchanges be designed to prevent fraudulent and manipulative acts and practices, 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.¹² Similarly, the Commission finds that the FINRA proposal is consistent with Section 15A(b)(6) of the Act,¹³ 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. The Commission also believes that the proposals are consistent with Section 11A(a)(1) of the Act¹⁴ in that they seek to assure fair competition among brokers and dealers and among exchange markets.

By requiring market makers to maintain quotes that are priced within a broad range around the NBBO, the proposed rules should help assure that quotations submitted

¹¹ 15 U.S.C. 78f(b)(5).

¹² In approving the proposed rule change, the Commission notes that it has considered the proposed rules' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹³ 15 U.S.C. 78o-3(b)(6).

¹⁴ 15 U.S.C. 78k-1(a)(1).

by market makers to an exchange or FINRA's ADF, and displayed to market participants, bear some relationship to the prevailing market price, and thus should promote fair and orderly markets and the protection of investors. In addition, by precluding market makers from submitting "stub" quotes that are so far away from the prevailing market price that they are not intended to be executed, the proposed rules should reduce the risk that trades will occur at irrational prices. As noted above, a large number of trades were executed at irrational prices on May 6, 2010 and were ultimately broken. In this respect, the proposals also should promote the goals of investor protection and fair and orderly markets. Finally, because the SROs are proposing uniform rules with respect to these market maker quoting obligations, the proposed rule changes as a whole will assure these baseline standards are applied throughout the equity markets.

The Commission also finds that the functionality proposed by BATS, BX and Nasdaq is consistent with Section 6(b)(5) of the Act,¹⁵ which, among other things, requires that the rules of national securities exchanges be designed to prevent fraudulent and manipulative acts and practices, 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. The proposed functionality should assist market makers on BATS, BX and Nasdaq in maintaining continuous, two-sided limit orders within the prescribed limits in the securities in which they are registered to satisfy their new quoting obligations.

¹⁵ 15 U.S.C. 78f(b)(5).

The Commission also finds good cause, pursuant to Section 19(b)(2) of the Act,¹⁶ for approving the proposed Amendments No. 1 on an accelerated basis. These amendments reflect the concern that the proposed market maker quoting obligations should not apply during times when market makers should be permitted to absorb material information affecting a security for which they are registered as a market maker, whether before or during the trading day, i.e., until there has been a regular-way transaction on a security's primary listing market or during a trading halt. Approving these amendments on an accelerated basis would allow these provisions to be effective as of the implementation date of the new market maker requirements.

¹⁶ 15 U.S.C. 78s(b)(2).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁷ that the proposed rule changes (SR-BATS-2010-025; SR-BX-2010-66; SR-CBOE-2010-087; SR-CHX-2010-22; SR-FINRA-2010-049; SR-NASDAQ-2010-115; SR-NSX-2010-12; SR-NYSE-2010-69; SR-NYSEAmex-2010-96; SR-NYSEArca-2010-83), as modified by Amendment No. 1, be, and hereby are, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁸

Florence E. Harmon
Deputy Secretary

¹⁷ 15 U.S.C. 78s(b)(2).

¹⁸ 17 CFR 200.30-3(a)(12).