rules and regulations thereunder applicable to national securities exchanges. In particular, the Commission finds that the proposed rule changes submitted by the Exchanges are consistent with the requirements of Section 6(b) of the Act[53] and with Section 6(b)(5) of the Act[54] 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.

In the Commission's view, the proposed rule changes will help assure that the determination of whether a clearly erroneous trade has occurred will be based on clear and objective criteria, and that the resolution of the incident will occur promptly through a transparent process. The proposed rule changes also should help assure consistent results in handling erroneous trades across the U.S. markets, thus furthering fair and orderly markets, the protection of investors and the public interest. Finally, the Commission notes that the proposed rule changes are being implemented on a pilot basis so that the Commission and the Exchanges can monitor the effects of the pilot on the markets and investors, and consider appropriate adjustments, as necessary.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[55] that the proposed rule changes (SR–BATS–2010–016; SR–BX–2010–040; SR–CBOE–2010–056; SR–CHX–2010–13; SR–EDGA–2010–03; SR–EDGX–2010–03; SR–ISE–2010–62; SR–NASDAQ–2010–076; SR–NSX–2010–07; SR–NYSE–2010–47; SR–NYSEAmex–2010–60; SR–NYSEArca–2010–58), be, and hereby are, approved.

By the Commission.

Elizabeth M. Murphy,

Secretary.

[FR Doc. 2010–23076 Filed 9–15–10; 8:45 am]

BILLING CODE 8010–01–P

[53] 15 U.S.C. 78f(b).

[54] 15 U.S.C. 78f(b)(5).

[55] 15 U.S.C. 78s(b)(2).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–62884; File Nos. SR–BATS–2010–018; SR–BX–2010–044; SR–CBOE–2010–065; SR–CHX–2010–14; SR–EDGA–2010–05; SR–EDGX–2010–05; SR–ISE–2010–66; SR–NASDAQ–2010–079; SR–NYSE–2010–49; SR–NYSEAmex–2010–63; SR–NYSEArca–2010–61; SR–NSX–2010–08]

Self-Regulatory Organizations; BATS Exchange, Inc.; NASDAQ OMX BX, Inc.; Chicago Board Options Exchange, Incorporated; Chicago Stock Exchange, Inc.; EDGA Exchange, Inc.; EDGX Exchange, Inc.; International Securities Exchange LLC; The NASDAQ Stock Market LLC; New York Stock Exchange LLC; NYSE Amex LLC; NYSE Arca, Inc.; National Stock Exchange, Inc.; Order Approving Proposed Rule Changes Relating to Expanding the Pilot Rule for Trading Pauses Due to Extraordinary Market Volatility to the Russell 1000® Index and Specified Exchange Traded Products

September 10, 2010.

I. Introduction

On June 30, 2010, each of BATS Exchange, Inc. ("BATS"), NASDAQ OMX BX, Inc. ("BX"), Chicago Board Options Exchange, Incorporated ("CBOE"), Chicago Stock Exchange, Inc. ("CHX"), EDGA Exchange, Inc ("EDGA"), EDGX Exchange, Inc. ("EDGX"), International Securities Exchange LLC ("ISE"), The NASDAQ Stock Market LLC ("NASDAQ"), New York Stock Exchange LLC ("NYSE"), NYSE Amex LLC ("NYSE Amex"), NYSE Arca, Inc. ("NYSE Arca"), and National Stock Exchange, Inc. ("NSX") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1)[1] of the Securities Exchange Act of 1934 ("Act"),[2] and Rule 19b–4 thereunder,[3] proposed rule changes to amend certain of their respective rules to expand the trading pause pilot in individual stocks comprising the S&P 500® Index ("S&P 500") when the price moves ten percent or more in the preceding five minute period to securities included in the Russell 1000® Index ("Russell 1000") and specified Exchange Traded Products ("ETPs").[4] The proposed rule changes were published for comment in the **Federal Register** on July 7, 2010.[5] The Commission received 19 comments on the proposal and on broader issues relating to the effectiveness of the circuit breaker pilot program to date.[6]

[1] 15 U.S.C. 78s(b)(1).

[2] 15 U.S.C. 78a.

[3] 17 CFR 240.19b–4.

[4] The term "Exchanges" shall refer collectively to all of the exchanges in this order. The term "Listing Markets" refers collectively to NYSE, NYSE Amex, NYSE Arca, and NASDAQ. The term "Nonlisting Markets" refers collectively to the remaining national securities exchanges.

The Commission notes that NYSE and NYSE Amex do not currently trade ETPs. Therefore, the expansion of the pilot to the select list of ETPs does not apply to these two markets.

For purposes of Phase II, ETPs consist of exchange-traded funds (including widely traded broad-based funds like SPY), exchange-traded vehicles (which track the performance of an asset or index, providing investors with exposure to futures contracts, currencies and commodities without actually trading futures or taking physical delivery of the asset), and exchange-traded notes.

[5] *See* Securities Exchange Act Release Nos. 62407 (June 30, 2010), 75 FR 39060 (July 7, 2010); 62415 (June 30, 2010), 75 FR 39086 (July 7, 2010); 62409 (June 30, 2010), 75 FR 39078 (July 7, 2010); 62408 (June 30, 2010), 75 FR 39065 (July 7, 2010); 62417 (June 30, 2010), 75 FR 39074 (July 7, 2010); 62418 (June 30, 2010), 75 FR 39084 (July 7, 2010); 62419 (June 30, 2010), 75 FR 39070 (July 7, 2010); 62414 (June 30, 2010), 75 FR 39081 (July 7, 2010); 62411 (June 30, 2010), 75 FR 39067 (July 7, 2010); 62412 (June 30, 2010), 75 FR 39073 (July 7, 2010); 62413 (June 30, 2010), 75 FR 39076 (July 7, 2010); and 62410 (June 30, 2010), 75 FR 39063 (July 7, 2010) ("Phase II Circuit Breaker Pilot Notices").

On June 30, 2010, FINRA filed a proposed rule change, which was approved today. *See* Securities Exchange Act Release No. 62416 (June 30, 2010), 75 FR 39069 (July 7, 2010); Securities Exchange Act Release No. 62883 (September 10, 2010) (SR–FINRA–2010–033).

[6] The Commission considered letters received as of August 25 discussing the concept of the effectiveness of the individual stock circuit breaker pilot to date as well as formal letters citing the rule filings. *See* Letter from Paul Schott Stevens, President & CEO, Investment Company Institute to Chairman Schapiro, Commission, dated June 22, 2010 ("ICI Letter"); Letter from Craig S. Donohue, CEO, CME Group, Inc. to Chairman Schapiro, Commission, dated June 23, 2010 ("CME Letter"); Letter from Ann L. Vlcek, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association to Elizabeth M. Murphy, Secretary, Commission, dated June 25, 2010 ("SIFMA Letter"); Letter from Peter Skopp, President, Molinete Trading Inc. to Elizabeth M. Murphy, Secretary, Commission, dated July 8, 2010 ("Molinete Letter"); Letter from Sal L. Arnuk, Co-Head, and Joseph Saluzzi, Co-Head, Themis Trading to Elizabeth M. Murphy, Secretary, Commission, dated July 8, 2010 ("Themis Letter"); Letter from Peter A. Ianello, Partner, CSS, LLC to Elizabeth M. Murphy, Secretary, Commission, dated July 15, 2010 ("CSS Letter"); Letter from Julie S. Sweet, General Counsel, Secretary, Chief Compliance Officer, Accenture plc to Elizabeth M. Murphy, Secretary, Commission, dated July 15, 2010 ("Accenture Letter"); Letter from Patrick J. Healy, CEO, Issuer Advisory Group, LLC, Washington, District of Columbia to Elizabeth M. Murphy, Secretary, Commission, dated July 18, 2010 ("Issuer Advisory Group Letter"); Letter from Alexander M. Cutler, Chair, Business Roundtable Corporate Leadership Initiative, Business Roundtable, to Elizabeth M. Murphy, Secretary, Commission, dated July 19, 2010 ("Business Roundtable Letter"); Letter from Geva Patz, Android Alpha Fund to Elizabeth M. Murphy, Secretary, Commission, dated July 19, 2010 ("Android Alpha Fund Letter"); Letter from David C. Cushing, Director of Global Equity Trading, Wellington Management Company, LLP to Elizabeth M. Murphy, Secretary, Commission, dated July 19, 2010 ("Wellington Letter"); Letter from Karrie McMillan, General Counsel, Investment Company Institute to Elizabeth M. Murphy, Secretary,

The NYSE responded to the comments in a letter dated July 23, 2010,[7] and in a letter dated August 25, 2010.[8] Nasdaq submitted a response on August 26, 2010.[9]

The Commission finds that the proposals are consistent with Section 6(b)(5) of the Act,[10] as it believes that expanding the uniform, market-wide trading pauses will serve to prevent potentially destabilizing price volatility and will thereby help promote the goals of investor protection and fair and orderly markets. This order approves the proposed rule changes.

II. Description of the Proposals

On May 6, 2010, the U.S. equity markets experienced a severe disruption.[11] 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 were broken by the Exchanges. The Commission is concerned that events such as those that occurred on May 6 can seriously undermine the integrity of the U.S. securities markets. Accordingly, it is working on a variety of fronts to assess the causes and contributing factors of the May 6 market disruption and to fashion policy responses that will help prevent a recurrence.

The Commission also recognizes the importance of moving quickly to implement appropriate steps that could help limit potential harm from extreme price volatility. In this regard, it is pleased that the SROs began consulting soon after May 6 in an effort to develop consistent circuit breaker rules that could be implemented on an expedited basis. The SROs were able to reach agreement on a consistent approach and, on May 18 and 19, 2010, all of the SROs filed proposed rule changes with the Commission.

On June 10, 2010, the Commission granted accelerated approval, for a pilot period to end December 10, 2010, for proposed rule changes by the Exchanges to pause trading during periods of extraordinary market volatility in S&P 500 stocks (the "Phase I Circuit Breaker Pilot").[12] The rules require the Listing Markets to issue five-minute trading pauses for individual securities for which they are the primary Listing Market if the transaction price of the security moves ten percent or more from a price in the preceding five-minute period. The Listing Markets are required to notify the other Exchanges and market participants of the imposition of a trading pause by immediately disseminating a special indicator over the consolidated tape. Under the rules, once the Listing Market issues a trading pause, the other Exchanges are required to pause trading in the security on their markets.

At the end of the five-minute pause, the Listing Market reopens trading in the security in accordance with its procedures for doing so. Trading resumes on other Exchanges and in the over-the-counter (OTC) market once trading has resumed on the Listing Market. In the event of a significant imbalance on the Listing Market at the end of the trading pause, the Listing Market may delay reopening. If the Listing Market has not reopened within ten minutes from the initiation of the trading pause, however, the other Exchanges may resume trading.[13]

Several commenters on the proposal for the Phase I Circuit Breaker Pilot expressed the view that the circuit breaker pilot should be expanded beyond S&P 500 stocks, particularly to exchange traded funds ("ETFs") and the securities of other companies that were most severely affected by the market disruption on May 6, 2010.[14] In the approval order for the Phase I Circuit Breaker Pilot, the Commission agreed that consideration should be given by the Exchanges to whether the circuit breakers should be expanded to cover additional securities, but did not believe that there was a reason to delay implementation of the Phase I Circuit Breaker Pilot as a reasonable first step to address potential market volatility.

Under the current proposal, the Exchanges propose to add securities included in the Russell 1000, as well as specified ETPs, to the pilot (the "Phase II Circuit Breaker Pilot") shortly after the Commission approves the proposed rule changes. The Exchanges believe that adding these securities to the pilot would have the beneficial effect of applying the circuit breakers' protections against excessive volatility to a larger group of securities, while at the same time allowing the opportunity, during the pilot period, for continued review of the operation of the circuit breakers and an assessment of whether the pilot should be further expanded or modified.

The Exchanges believe that the securities in the Russell 1000 have similar trading characteristics to securities included in the S&P 500, and therefore the 10% price movement that triggers a trading pause in the Phase I Circuit Breaker Pilot is appropriate for Russell 1000 securities. Based on the analyses of certain of the Exchanges, the number of times that the trading pause would be triggered for Russell 1000

Commission, dated July 19, 2010 ("ICI 2 Letter"); Letter from Ira P. Shapiro, Managing Director, BlackRock, Inc., San Francisco, California to Elizabeth M. Murphy, Secretary, Commission, dated July 19, 2010 ("BlackRock Letter"); Letter from Tom Quaadman, Vice President, Center for Capital Markets Competitiveness, Washington, District of Columbia to Elizabeth M. Murphy, Secretary, Commission, dated July 19, 2010 ("CCMC Letter"); Letter from James J. Angel, Associate Professor of Finance, Georgetown University, dated June 19, 2010 [sic] ("Angel Letter"); Letter from John A. McCarthy, General Counsel, GETCO to Elizabeth M. Murphy, Secretary, Commission, dated July 20, 2010 ("GETCO Letter"); Letter from Jose Marques, Managing Director, Deutsche Bank Securities Inc. to Elizabeth M. Murphy, Secretary, Commission, dated July 21, 2010 ("Deutsche Bank Letter"); Letter from Paul Schott Stevens, President & CEO, Investment Company Institute to Chairman Schapiro, Commission, dated July 27, 2010 ("ICI 3 Letter"); Letter from Craig S. Donohue, Chief Executive Officer, CME Group to Elizabeth M. Murphy, Secretary, Commission, dated July 30, 2010 (CME 2 Letter").

[7] *See* Letter from Janet M. Kissane, Senior Vice President—Legal & Corporate Secretary, NYSE Euronext to Elizabeth M. Murphy, Secretary, Commission, dated July 23, 2010 ("Response Letter").

[8] *See* Letter from Janet M. Kissane, Senior Vice President—Legal & Corporate Secretary, NYSE Euronext to Elizabeth M. Murphy, Secretary, Commission, dated August 25, 2010.

[9] *See* Letter from Thomas P. Moran, Associate General Counsel, The NASDAQ Stock Market LLC to Elizabeth M. Murphy, Secretary, Commission, dated August 26, 2010.

[10] 15 U.S.C. 78f(b)(5). That section, 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.

[11] 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 CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues*, "Preliminary Findings Regarding the Market Events of May 6, 2010," dated May 18, 2010 ("Joint Report").

[12] *See* Securities Exchange Act Release No. 62252 (June 10, 2010), 75 FR 34186 (June 16, 2010) ("Phase I Approval Order").

[13] For more details on the operation of the Exchanges' rule, *see* Securities Exchange Act Release No. 62252.

[14] *See, e.g.*, Letter from Jeffrey W. Rubin, American Bar Association Business Law Section to Elizabeth M. Murphy, Secretary, Commission, dated June 3, 2010; Letter from Julie Sweet, Accenture plc to Elizabeth M. Murphy, Secretary, Commission, dated June 3, 2010; and Letter from Karrie McMillan, Investment Company Institute to Elizabeth M. Murphy, Secretary, Commission, dated June 3, 2010 (expressing particular concern that if circuit breakers exist for individual securities contained in ETFs' baskets, but not for the ETFs themselves, ETFs could again suffer disproportionately during a market event such as that of May 6).

securities would be similar to the number of instances for S&P 500 securities.

In addition, the Exchanges proposed to include in the Phase II Circuit Breaker Pilot the more liquid ETPs—specifically, those with a minimum average daily volume of $2,000,000—that tend to have similar trading characteristics as securities in the S&P 500 and Russell 1000 and for which they believe a 10% circuit breaker trigger is appropriate.[15] In addition, to assure related ETPs are subject to comparable circuit breakers, the Exchanges proposed to include any ETP that did not meet the $2,000,000 average daily volume threshold, but tracked similar stocks and indices as ETPs meeting this criterion and proposed to be included in the pilot. ETPs with average-daily-volumes of less than $2,000,000, and for which there were no high-volume counterparts were not included. Also excluded were leveraged ETFs since those products by design are more volatile than the underlying stocks they track, and the current proposal only contemplates adding securities for which a 10% trigger is appropriate.[16]

As proposed, the list of ETPs includes those that track broad-based equity indices, which the Exchanges recognize has caused some debate. For example, as described in Section III, concerns have been raised about the effect that halting trading in an index-based ETP may have on a related index-based option or future. However, the Exchanges believe that including broad-based index ETPs is appropriate so that ETP investors are protected should the component securities experience such volatility that trading in the broad-based ETP is affected. Because the proposal is for a pilot period, the Exchanges will continue to assess, among other things, whether it is appropriate to have a trading pause in broad-based index ETPs when there is not a similar trading pause in related index-based options or futures.

In addition, during the pilot period, the Exchanges will continue to assess whether specific stocks or ETPs should be added to, or removed from, the list of securities subject to the circuit breakers. The Exchanges will also continue to assess whether the parameters for invoking a trading pause continue to be appropriate or should be modified.[17]

III. Discussion of Comments and Commission Findings

As of August 25, 2010, the Commission received 19 comment letters regarding the proposed rule changes. Many commenters supported the Phase II Circuit Breaker Pilot and its expansion to the Russell 1000 and the specified ETPs.[18] For example, one commenter encouraged the Commission to act expeditiously to expand the scope of the trading halt rules to securities other than the S&P 500, particularly to ETFs, and noted that ETFs experienced significant volatility on May 6, 2010 and would benefit from uniform pauses in trading.[19] Another commenter urged the Commission to approve the Phase II Circuit Breaker Pilot as quickly as possible, arguing that many of the securities that experienced the most extreme trading jolts on May 6, 2010 were not included in the Phase I Circuit Breaker Pilot, and that expansion of the pilot was appropriate both to protect additional companies from potential aberrational price movements and liquidity events affecting their securities, and to provide investors with greater certainty about the availability of the circuit breakers.[20] Yet another commenter noted that expanding the trading halt pilot to securities in the Russell 1000 would protect investors in publicly traded companies not in the S&P 500 that experienced severely aberrational trading on May 6.[21]

Some commenters raised concerns about the proposed rule changes. The two main areas of concern were: (1) The ability of erroneous trades to trigger a trading pause; and (2) whether ETPs—particularly broad-based index products—should be included in the pilot.

1. Erroneous Trades Triggering the Trading Pause

Several commenters pointed out that, under the circuit breaker pilot, erroneous trades can trigger—and have triggered—trading pauses, when there otherwise is no extraordinary market volatility.[22] One commenter asserted that under the current circuit breaker logic, erroneous trades would have triggered a trading halt at least 238 times in the past 18 months.[23] This same commenter pointed out that, as of the date of its letter, three stocks had been halted under the Phase I Circuit Breaker Pilot, two of which were triggered on markets with prices that were far away from the current national best bid or offer ("NBBO") and prevailing prices at other markets.[24]

Other commenters expressed concern that any trader in the world, ill-intentioned[25] or not, has the power to halt trading in a stock simply by printing a trade outside the circuit breaker range on a trade reporting facility for the OTC market.[26] One of these commenters suggested that either a minimum number of trades outside the circuit breaker range occur before trading is halted, or that the trade first be checked for consistency with the NBBO before trading is halted.[27]

Several commenters concerned with erroneous trades triggering the circuit breakers offered alternatives to the "trading pause" mechanism used in the current pilot. A number of commenters suggested that the Commission consider moving to a "limit up/limit down" approach to moderate market volatility, similar to that utilized in the futures markets.[28] Some commenters also encouraged the Commission to consider adopting collars on market orders and eliminating stub quotes.[29] One commenter suggested that the markets trigger the single stock circuit breakers

[15] For details on how the Exchanges developed the pilot list of ETPs, *see, e.g.,* Securities Exchange Act Release No. 62413 (June 30, 2010), 75 FR 39076 (July 7, 2010) (SR–NYSEArca–2010–61).

[16] One consequence of excluding leveraged ETFs is that they could still suffer significant price dislocations even though trading in the stocks they track might be paused as discussed above.

The Exchanges do not believe that the 10% price movement is an appropriate threshold for leveraged ETPs because, by definition, leveraged ETPs are based on multiples of price movements in the underlying index. Accordingly, a 10% percent price movement in a leveraged ETP may not signify extraordinary volatility. Because the Exchanges are not proposing to adopt revised price movement thresholds at this time, they are not proposing to include leveraged ETPs for now.

[17] *See* Phase II Circuit Breaker Pilot Notices, *supra* note 5.

[18] *See* Accenture Letter, Business Roundtable Letter; CCMC Letter; ICI Letter; ICI 2 Letter; ICI 3 Letter; Issuer Advisory Group Letter; Wellington Letter; Deutsche Bank Letter; SIFMA Letter; and BlackRock Letter.

[19] *See* SIFMA Letter.

[20] *See* Business Roundtable Letter.

[21] *See* Accenture Letter.

[22] *See, e.g.,* Themis Letter; Accenture Letter; Molinete Letter; SIFMA Letter; and Angel Letter.

[23] *See* Molinete Letter.

[24] *Id.* (referring to the trading pauses in Citigroup on June 29, 2010 and in Anadarko Petroleum on July 6, 2010). As of August 25, stock-specific circuit breakers have been triggered seven times in six stocks.

[25] The Commission notes that anyone reporting a trade with the intention of triggering a trading pause could be charged with manipulation, fraud or other violations of the Federal securities laws.

[26] *See* Themis Letter and Angel Letter.

[27] *Id.*

[28] *See* SIFMA Letter; Accenture Letter; Wellington Letter; and CME 2 Letter. Under this approach, trades could occur within the established price bands, so that erroneous trades would largely be eliminated. In addition, there would not be a complete trading halt—trading would be prevented outside the applicable price band, but could continue within it.

[29] *See* SIFMA Letter and CME 2 Letter.

off of changes to the NBBO rather than to changes in the last trade price.[30]

The Commission believes that the ability of an erroneous trade to trigger a trading pause is a concern that the Exchanges should seek to address promptly. The Commission understands that the Exchanges are working on a variety of measures to reduce the instances of erroneous trades and to assure that, when they occur, they are resolved promptly through a clear and transparent process.[31] The Commission also notes that, under the pilot rules, the Listing Market can exclude a transaction price that results from an erroneous execution from triggering a circuit breaker. In this regard, the Commission notes that the Listing Markets, pursuant to this authority, intend to implement automated processes to help prevent trades that may be erroneous—specifically, those outside the NBBO—from triggering a circuit breaker.[32] Various Exchanges have taken steps to "collar" market orders, which are intended to prevent executions that occur a specified percentage away from the last sale,[33] and Commission staff has been working with the Exchanges on an initiative to prevent stub quotes. The Commission, in conjunction with the Exchanges, will continue to evaluate what further steps need to be taken to reduce the likelihood of erroneous trades and to improve the efficiency of the pilot. However, the Commission does not believe it is appropriate to delay implementation of the Phase II Circuit Breaker Pilot pending the conclusion of those efforts.

2. Inclusion of ETPs

Many commenters addressed the inclusion of ETPs in the pilot program.[34] Several supported the proposed expansion of the Phase II Circuit Breaker Pilot to include ETPs.[35] One of these commenters stated that ETFs experienced significant volatility on May 6, and would benefit from a uniform trading pause.[36] Another commenter noted that the price of an ETF is typically highly correlated to the market price of its basket of component securities.[37] Under normal circumstances, when trading has been halted for one or two component securities, an ETF may experience a slight deviation from the price of its basket because of the challenge of pricing the non-trading security, and may trade with a wider spread to account for the associated risk. When multiple underlying securities are affected, however, the correlation between the prices of an ETF and its underlying basket may break down and the ETF may experience more severe price dislocation.[38] While this commenter thought that a different circuit breaker trigger may be appropriate for ETFs, it nonetheless encouraged the Commission to include all ETFs in the pilot where a substantial number of the component securities are subject to the circuit breakers.[39] Doing otherwise, in its view, creates risks that ETFs could again suffer disproportionately during a market event similar to that of May 6.[40]

One commenter supported the inclusion of ETFs in the pilot program, in part because halting trading in the underlying component securities, but not in the ETF, would hinder the arbitrage mechanism that is critical to the ability of ETFs to track the performance of their underlying basket or benchmark index.[41] According to this commenter, if an ETF were allowed to continue to trade while trading in the majority of its underlying securities were halted, the arbitrage mechanism would not work effectively, with the result that liquidity for the ETF would diminish greatly, and perhaps lead to a collapse in price similar to that which occurred on May 6.[42]

Other commenters criticized various aspects of the application of the proposed rule change to ETPs. One commenter described certain ETFs—such as the S&P 500 SPDR (SPY)—as "systemically important," and expressed concern that halting trading in these ETFs, especially as a result of erroneous trades, might destabilize markets. Because the SPY, for example, is used as a hedging vehicle in many trading strategies, halting trading in it could cause liquidity providers broadly to withdraw from the market, increasing volatility and perhaps leading to a chain reaction like that witnessed on May 6.[43] This commenter did not believe that allowing ETFs to continue to trade while some of the underlying component securities were halted would be detrimental, because market participants would determine their own fair value of the halted component securities.[44]

Another commenter expressed significant concern with the proposed expansion of the pilot to broad-based equity index ETFs, as it believed there could be potentially significant disruptions to trading across related markets.[45] This commenter noted that

[30] *See* Molinete Letter. As an alternative, this commenter suggested requiring at least two consecutive trades outside the NBBO to trigger the circuit breaker, and the exclusion of manually-entered trades from being potential triggers.

[31] *See* SR–BATS–2010–016; SR–BX–2010–040; SR–CBOE–2010–056; SR–CHX–2010–13; SR–EDGA–2010–03; SR–EDGX–2010–03; SR–FINRA–2010–032; SR–ISE–2010–62; SR–NASDAQ–2010–076; SR–NSX–2010–07; SR–NYSE–2010–47; SR–NYSEAmex–2010–60; SR–NYSEArca–2010–58 (proposed rule changes to amend certain SRO rules to set forth clearer standards and curtail SRO discretion with respect to breaking erroneous trades).

[32] *See* Letter from Janet M. Kissane, Senior Vice President—Legal & Corporate Secretary, NYSE Euronext to Elizabeth M. Murphy, Secretary, Commission, dated August 25, 2010; Letter from Thomas P. Moran, Associate General Counsel, The NASDAQ Stock Market LLC to Elizabeth M. Murphy, Secretary, Commission, dated August 26, 2010. The Listing Markets may roll out these new automated processes on a staggered basis.

In addition, the Commission understands FINRA is developing more effective ways to prevent erroneous OTC trades from being printed on a trade reporting facility, and it encourages those efforts. *See, e.g.,* FINRA Trade Reporting Notice, dated August 19, 2010 (issuing new guidance on the use of the weighted-average price/special pricing formula (.W) trade modifier for reporting certain types of OTC trades in NMS stocks to FINRA).

[33] *See, e.g.,* Securities Exchange Act Release Nos. 62485 (July 13, 2010), 75 FR 41914 (July 19, 2010) (SR–NYSEArca–2010–67); 60371 (July 23, 2009), 74 FR 38075 (July 30, 2009) (SR–NASDAQ–2009–70).

[34] *See* Accenture Letter; Android Alpha Fund Letter; BlackRock Letter; Business Roundtable Letter; CME Letter; CME 2 Letter; CCMC Letter; ICI Letter; ICI 2 Letter; ICI 3 Letter; Molinete Letter; SIFMA Letter.

[35] *See* Accenture Letter; BlackRock Letter; Business Roundtable Letter; CCMC Letter; ICI Letter; ICI 2 Letter; ICI 3 Letter; SIFMA Letter.

[36] *See* SIFMA Letter at 2.

[37] *See* ICI Letter and ICI 2 Letter.

[38] *Id.*

[39] *See* ICI Letter. In a subsequent letter, that commenter supported examining the connection between price discovery in the equities and the futures markets, and potentially making rules consistent across markets. *See* ICI 2 Letter. According to this commenter, however, such an examination should not prevent including broad-based index ETFs in the pilot program. *Id.*

[40] *See* ICI 2 Letter.

[41] *See* BlackRock Letter. According to the commenter, this arbitrage mechanism generally requires liquidity providers to sell a basket of stocks equivalent to an ETF's underlying portfolio (or a correlated derivative) as a hedge when purchasing ETF shares.

[42] *Id.* This commenter did, however, question the exclusion of lower-volume ETFs from the Phase II Circuit Breaker Pilot, and urged that these ETFs be included in the pilot at the earliest opportunity. *See* discussion on pages 6–7 describing the rationale for selecting the list of ETPs for inclusion in the pilot program.

[43] *See* Molinete Letter at 4.

[44] *Id.* at 4–5.

[45] *See* CME Letter and CME 2 Letter. This commenter expressed further concerns with the prospect of multiple constituent stocks in an index being halted without the market-wide circuit breaker being triggered. The commenter thought this would create complexity and confusion in understanding the index calculation. In addition, the commenter was of the view that the halting of high capitalization, highly-liquid index components would be disruptive because it could affect whether the index triggers a market-wide circuit breaker, the intra-day index values circulated for risk management purposes may not be reflective of the true value of the underlying market, and large liquidity providers in index futures and ETFs may have difficulty hedging with the result that they withdraw from the market.

the indices underlying the most active ETFs are the same as those underlying the most active cash index options, index futures, and options on ETFs.[46] If a different circuit breaker mechanism applied to broad-based equity index ETFs and ETF options than applied to index futures and index options, or differed from the overall market-wide circuit breakers, the commenter feared this could lead to further market stress during periods of turbulence, perhaps impeding liquidity and exacerbating risk management challenges.[47] In addition, the commenter thought that the inability of market makers to hedge using equity index ETFs during a trading pause could lead to their withdrawing liquidity across all markets, including in the E-mini index futures.[48] Accordingly, the commenter believed that the circuit breakers applicable to equity index-based ETFs (as well as index futures, index options, options on ETFs, and swaps) should be consistent with both the methodology and levels of the market-wide circuit breakers.[49] Specifically, the commenter recommended the adoption of uniform price limits across all broad-based index products based upon the S&P 500, the DJIA, and the NASDAQ 100, which would preclude trading beyond the enumerated limit but not within it.[50] This commenter also recommended that automated risk and volatility mitigation mechanisms be implemented in place of trading halts in individual securities.[51]

In its response to comments, NYSE stated that the "prompt review and implementation of revised and coordinated market wide circuit breakers is * * * a high priority."[52] NYSE also indicated that it would continue to review the operation of the pilot, including its effect on how index-based products trade across multiple markets, and would propose "such changes as may be warranted for those securities."[53]

The Commission believes that, on balance, the inclusion of ETPs, including broad-based index equity ETFs, in the Phase II Circuit Breaker Pilot is warranted and consistent with the Act. The Commission notes that there are a number of scenarios in which the application of a circuit breaker to trading in an ETF would promote market stability. For example, if an ETF triggers a circuit breaker when none of its component stocks is experiencing abnormal moves, then it is likely that the ETF is suffering from a temporary liquidity imbalance. In that case, the ETF would no longer be suitable for use as a hedging instrument because its price would no longer reflect an accurate consensus market value of the ETF or its underlying stocks. By pausing the ETF under these circumstances, the Exchanges would allow liquidity to rebuild and provide time for the market to self-correct without allowing the aberrant price of the ETF to adversely affect the trading and pricing of the underlying stocks, other ETFs or other related products.

In another scenario, an ETF might trigger a circuit breaker, even though its component stocks have not, because the ETF is leading its underlying stocks in price discovery. In that case, the prices of many of the underlying stocks may follow, triggering their own circuit breakers shortly after the ETF does. In a broad market event such as this, the net result would be that trading in the ETF and individual stocks have each been paused, providing time for the market as a whole to re-evaluate prices.

In yet another scenario, a number of individual component stocks might trigger their circuit breakers even though the related ETF has not yet done so. In that case, different market participants may very well have differing opinions on the market value for the ETF because they will be required to estimate the value of those component stocks that have been paused. If only a small number of component stocks is paused (perhaps due to some temporary liquidity imbalances in those stocks) then there likely would be minimal effect on the ETF, and the ETF circuit breakers appropriately would not be triggered. But if a large number of component stocks trigger halts, the market likely is experiencing a broad-based move, either for fundamental reasons, or because of a large-scale liquidity imbalance similar to that of May 6. As noted above, if many component stocks of an ETF are paused, but the ETF itself continues to trade, the arbitrage relationship between the ETF and its component stocks likely will break down as market participants find they cannot hedge their exposures and, as a consequence, cease to provide liquidity. Without a circuit breaker mechanism that also applies to ETFs, the ETF could experience excessive volatility that is not necessarily driven by the prices of its underlying stocks. By pausing the ETF, market participants would be given time to re-evaluate prices and replenish liquidity as needed.

The Commission acknowledges that a variety of ETFs do indeed trade without incident when most, and sometimes all, of their underlying components are not trading (*e.g.,* ETFs on international stocks). However, market makers and other participants trading these ETFs account for this known and permanent structural difference by building alternative methods for hedging and pricing into their trading models. Market participants trading ETFs for which the component stocks normally trade at the same time would not necessarily have the opportunity to implement new hedging and pricing strategies in real time if underlying component stocks were suddenly paused. Rather, they would most likely withdraw from the market leaving the ETF with little liquidity and even further need for a trading pause.[54]

The above arguments demonstrating the need to couple pauses in ETFs with pauses in underlying stocks are equally applicable to the futures market, and the Commission acknowledges the comments and concerns of the CME for consistent treatment across instrument types. However, the Commission notes that the CME's markets already have mechanisms for limiting or pausing trading, and thus some inconsistency exists today between the two markets. Maintaining the status quo, moreover,

---

[46] *Id.* The commenter also noted that these markets are very closely linked and the absence of effective coordination across comparable markets was one factor cited by many as having contributed to certain market issues experienced on May 6. The Commission addresses issues of cross-market linkage in its discussion *infra.*

[47] *Id.*

[48] *See* CME Letter.

[49] *See* CME Letter. This commenter also noted that, while approximately 70% of the trades broken on May 6, 2010 were in ETFs, they were not in the most liquid domestic, large cap index products.

[50] *See* CME 2 Letter. These price limits would be established at the 5%, 10% and 20% levels, and would be implemented for a 10 minute period, after which trading would continue to the next applicable limit.

[51] *Id.* Specifically, the commenter recommended that all markets adopt: (1) Automated means—similar to the commenter's stop logic functionality—to briefly pause the market in the event that cascading sell orders precipitate a material market decline because of a transitory dearth of liquidity; (2) functionality—similar to the commenter's protection point functionality—to automatically apply limit prices to all orders, including market and stop orders; and (3) automated price banding functionality and maximum order size restrictions to help prevent erroneous trades. For as long as single stock circuit breakers continue to be employed, however, the commenter believed regulators and the markets should establish uniform policies and procedures to address situations where the computation of the market-wide circuit breaker index value is negatively affected due to the triggering of stock specific circuit breakers on the component securities.

[52] *See* Response Letter.

[53] *Id.*

[54] The Commission notes that a pause in the ETF could also affect trading in underlying component stocks that were not otherwise halted to the extent that the ETF was no longer available as a hedging mechanism.

would leave ETFs without a trading pause mechanism. In addition, the Commission notes that there will need to be substantial work to determine how best to make the volatility constraints in the futures markets and the securities markets consistent.

Commenters also raised related concerns that a pause in a broad-based ETF (such as the SPY) could lead to significant liquidity pressures on other index-based products in the futures market (such as the E-mini).[55] Although this is a potential point of concern, as noted above the futures markets already have in place volatility mechanisms that should help mitigate the effect of such an event. Moreover, it should be noted that currently there could be a pause on the futures market (*e.g.,* in the E-mini) which could create liquidity pressure for corresponding ETFs—but there is currently no mechanism to protect the ETF against aberrant prices as a result of such liquidity pressures.

NYSE also recognized these concerns in its response to comments, and committed to working with regulators and other markets in coordinating alerts to trading interruptions "so consistent application of pauses will be effected."[56] NYSE also described "the prompt review and implementation of revised and coordinated market wide circuit breakers" as "a high priority."[57]

In response to the comment that the Commission instead implement automated risk and volatility mitigation mechanisms—such as price banding or stop logic functionality—the Commission notes that, even as the circuit breaker pilot is being expanded, the Commission is simultaneously exploring possible alternatives to a circuit breaker approach that may include price limit bands or other mechanisms described by the commenters.

One commenter noted that the proposal would exclude many ETFs with trading volumes below the criteria set by the Exchanges and FINRA, although such ETFs were significantly affected in the cancelled trades of May 6.[58] The Commission acknowledges that fact, but notes that, as the Exchanges have indicated, the potential application of the circuit breakers to less liquid securities is more complex, as different triggering thresholds may be appropriate for them. As the pilot progresses, the Commission will work with the SROs to consider expanding the circuit breakers to cover additional securities in an appropriate manner.

The Commission acknowledges the point made by commenters that broad-based index products were not significantly implicated in the cancelled trades on May 6.[59] However, the Commission notes that broad-based index products did experience substantial volatility on May 6[60] and, like other securities, could benefit from the protections of a circuit breaker. In addition, a sudden change in price, due to a loss of liquidity or otherwise, to a widely traded ETF could have an adverse market-wide effect even more far-reaching than that of May 6. It is important that the use of circuit breakers not be limited to only those ETFs that happened to have experienced severe dislocations on May 6, since there is no fundamental reason why broad-based ETFs could not experience a similar liquidity crisis. In addition, there were no circuit breakers in effect for underlying stocks on May 6. If a similar event occurred when many underlying stocks in an index were halted by circuit breakers, broad-based ETFs could experience greater volatility than occurred on May 6.

3. Other Areas of Comment

Other areas of comment included potential ways to expand or modify the circuit breaker pilot going forward,[61] the need to carefully study the effect of the pilot,[62] the effect and continued advisability of individual market volatility moderators in addition to the uniform single-stock circuit breakers,[63] and possible modifications to the market-wide circuit breakers.[64]

With regard to expanding or modifying the circuit breaker pilot, as noted above, the Commission intends to continue working with the Exchanges to consider expanding the pilot to include additional securities, or modifying the circuit breaker mechanism or pursuing other approaches to moderating market volatility, in the coming months. In addition, as noted in the Joint Report, the Commission currently is evaluating the extent to which individual market volatility moderators exacerbated the market instability that occurred on May 6, 2010, and expects to develop appropriate policy recommendations based on the outcome of that analysis. Finally, as noted in the Joint Report, the Commission intends to work with the CFTC to consider whether modifications to the existing market-wide circuit breakers are warranted in light of the events of May 6. While all of these issues warrant further study in the coming months, the Commission does not believe they provide a basis for not approving the Phase II Circuit Breaker Pilot at this time. The fact that better alternatives to address inordinate market volatility ultimately may be developed does not provide a basis for the Commission not to approve the Exchanges' proposals if, as the Commission believes, the proposed rule changes are consistent with Section 6(b)(5) of the Act.

4. Findings

The Commission finds that the proposed rule changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to national securities exchanges. In particular, the Commission finds that the proposals are consistent with Section 6(b)(5) of the Act,[65] 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.[66]

The proposed rule changes will expand the trading pause pilot to include the securities in the Russell 1000 and specified ETPs. The Commission believes that expanding the uniform, market-wide trading pauses will serve to prevent potentially destabilizing price volatility and will thereby help promote the goals of investor protection and fair and orderly markets.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[67] that the proposed rule changes (SR–BATS–2010–018; SR–BX–2010–044; SR–

[55] *See* CME Letter.

[56] *See* NYSE Response Letter.

[57] *Id.*

[58] *See* BlackRock Letter.

[59] *See* CME Letter.

[60] *See* Joint Report, *supra* note 11, at 39 (noting that many ETFs "experienced extreme daily lows" on May 6, and that a "significant number of ETFs" experienced extreme daily highs on May 6).

[61] *See* Angel Letter (recommending that the trading pause be expanded to cover the open, close, and after-hours trading); ICI Letter (recommending examining whether a different circuit breaker trigger is appropriate for ETFs); Wellington Letter (recommending that the Commission require the Exchanges to continuously disclose the high/low trigger of a security and its maximum remaining life).

[62] *See* Android Alpha Fund Letter.

[63] *See* Deutsche Bank Letter.

[64] *See* CME 2 Letter; SIFMA Letter.

[65] 15 U.S.C. 78f(b)(5).

[66] 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).

[67] 15 U.S.C. 78s(b)(2).

CBOE–2010–065; SR–CHX–2010–14; SR–EDGA–2010–05; SR–EDGX–2010–05; SR–ISE–2010–66; SR–NASDAQ–2010–079; SR–NYSE–2010–49; SR–NYSEAmex–2010–63; SR–NYSEArca–2010–61; SR–NSX–2010–08) be, and hereby are, approved.

By the Commission.

Elizabeth M. Murphy,

Secretary.

[FR Doc. 2010–23074 Filed 9–15–10; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–62876; File No. SR–Phlx-2010–120]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NASDAQ OMX PHLX, Inc. To Establish Fees for NASDAQ OMX PSX

September 9, 2010.

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 August 31, 2010, NASDAQ OMX PHLX, Inc. (“Phlx” or “Exchange”) 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 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 adopt new fees in connection with the trading of NMS stocks through the new NASDAQ OMX PSX system (“PSX”). The text of the proposed rule change is available on the Exchange’s Web site at *http://nasdaqtrader.com/micro.aspx?id=PHLXfilings,* on the Commission’s Web site at *http://www.sec.gov,* 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 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

Shortly after its acquisition by The NASDAQ OMX Group, Inc. (“NASDAQ OMX”) in 2008, the Exchange ceased operation of XLE, its former system for trading NMS stocks.[3] Earlier this year, the Exchange filed a proposed rule change to resume trading NMS stocks through a new electronic platform known as NASDAQ OMX PSX.[4] In anticipation of approval and launch of PSX, the Exchange is filing this proposed rule change to establish fees, dues, and other charges applicable to PSX. The proposed fees are structurally similar to those of the Exchange’s affiliated exchanges, The NASDAQ Stock Market LLC (the “NASDAQ Exchange”) and NASDAQ OMX BX, Inc. (“BX”), but with the omission of fees that are not pertinent to the Exchange’s planned business and with differences in the level of certain fees.

Order Execution Fees

Order execution fees will be uniform for all types of securities and member organizations. Specifically, for securities executed at prices of $1 or more, the Exchange will charge $0.0013 per share executed and pay a liquidity provider rebate of $0.0020 per share executed. For executions below $1, the execution fee will be 0.2% of the total transaction cost, and the rebate will be $0. The Exchange proposes this “inverted” pricing structure as a temporary promotional mechanism to attract liquidity to PSX. Other exchanges and trading venues have adopted inverted pricing in the past as a means to promote the development of a new market entrant.[5]

PSX TotalView

The Exchange proposes to establish fees for its PSX TotalView data product. Like NASDAQ TotalView and BX TotalView, PSX TotalView will provide all Displayed Orders in the market at every price level.[6] In recognition of the start-up nature of the new market, the data feed will be provided free of charge to subscribers and distributors for a period ending on the last day of the twelfth full calendar month of PSX’s operation. Thus, if PSX commences operations on September 27, 2010, PSX TotalView fees will be waived until October 1, 2011.

After the initial free period, the Exchange will offer users a range of pricing options. In general, charges will be assessed to distributors of PSX Total View on a per distributor basis, with additional charges assessed on a per subscriber basis for each subscriber receiving the data from a distributor. A “distributor” is defined as any entity that receives a feed or data file of Exchange data directly from the Exchange (a “direct distributor”) or indirectly through another entity (an “indirect distributor”) and then distributes the data either internally (within that entity) or externally (outside that entity). Distributors of PSX TotalView will pay a $1,000 monthly fee to receive the data directly from the Exchange (including from the Exchange through an extranet); indirect distributors would not pay this charge. Distributors will also pay either a $500 monthly fee to distribute the data feed internally (i.e., to employees) or a $1,250 monthly fee to distribute to external customers (as well as internally, if applicable). All of the foregoing fees will be waived during the initial free period. Finally, distributors receiving any PSX TotalView or any other PSX data feed will be charged an annual administrative fee: either $500 for delayed distribution of data, or $1,000 for real-time distribution.[7] The administrative fees, which are assessed annually, will be charged at the beginning of the first calendar year after the launch of PSX, rather than being subject to the one-year free period applicable to other data fees. If, as the Exchange expects, PSX launches in

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 58613 (September 22, 2008), 73 FR 57181 (October 1, 2008) (SR–PHLX–2008–65).

[4] Securities Exchange Act Release No. 62519 (July 16, 2010), 75 FR 43597 (July 26, 2010) (SR–PHLX–2010–79).

[5] *See, e.g.,* Securities Exchange Act Release No. 59452 (February 25, 2009), 74 FR 9456 (March 4, 2009) (SR–BX–2009–012) (temporarily decreasing order execution fee to a level below prevailing liquidity provider rebate); BATS ECN Unveils Ultra-Aggressive January Pricing Special (December 19, 2006) (available at *http://www.batstrading.com/resources/press_releases/BATS%20ECN%20Unveils%20Ultra-Aggressive%20January%20Pricing%20Special.pdf).*

[6] In contrast with the NASDAQ Exchange and BX, however, all orders designated as Displayed Orders will be displayed without attribution to the entering market participant.

[7] These annual administrative fees may be waived for colleges and universities receiving the data for research and educational purposes.