

Single-Stock Circuit Breakers And Potentially Erroneous Trades

Amendments to FINRA Rules on Trading Pauses Due to Extraordinary Market Volatility and Clearly Erroneous Transactions in Exchange-Listed Securities

Effective Dates: Amendments to Rule 11892 Became
Effective September 10, 2010; Amendment to Rule 6121
Became Effective September 14, 2010

Executive Summary

On September 14, 2010, FINRA's individual stock trading-pause (also called a single-stock circuit breaker) pilot was expanded to include securities in the Russell 1000® Index as well as a pilot list of exchange traded products (ETPs).¹

On September 10, 2010, amendments to FINRA's clearly erroneous rules that refine and clarify the process for making clearly erroneous determinations for over-the-counter (OTC) transactions in exchange-listed securities, including events involving multiple stocks, became effective on a pilot basis. Both pilots are set to end on December 10, 2010.

The text of the amendments can be found in the *FINRA Manual* at www.finra.org/finramanual.

Questions regarding this *Notice* should be directed to:

- FINRA Operations at (866) 776-0800; or
- Racquel Russell, Assistant General Counsel, Office of General Counsel, at (202) 728-8363.

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Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management
- Systems
- Trading and Market Making

Key Topic(s)

- Clearly Erroneous Transactions
- Quotations
- Trading Halts

Referenced Rules & Notices

- FINRA Rule 5260
- FINRA Rule 6121
- FINRA Rule 11892

Background and Discussion

On September 10, 2010, the SEC approved amendments to FINRA Rule 6121 (Trading Halts Due to Extraordinary Market Volatility) to expand the trading-pause pilot, originally adopted on June 10, 2010,² to include all stocks in the Russell 1000 Index and specified ETPs.³ Consistent with the original pilot, the expanded pilot provides that whenever a primary listing market issues a trading pause in a security, FINRA will similarly halt OTC trading by FINRA member firms, including alternative trading systems and market makers. As was the case under the original pilot, FINRA will generally halt OTC trading until trading has resumed on the primary listing market.⁴ FINRA reminds firms of their obligation to have policies and procedures in place that are reasonably designed to ensure that, among other things, they promptly cease effecting transactions during a trading halt as required by FINRA Rule 5260 (Prohibition on Transactions, Publication of Quotations, or Publication of Indications of Interest During Trading Halts).

The SEC also approved amendments to FINRA Rule 11892 (Clearly Erroneous Transactions in Exchange-Listed Securities) that include changes to clarify the process for reviewing potentially erroneous trades in exchange-listed securities.⁵ The amendments are intended to, among other things, provide for uniform treatment of clearly erroneous reviews of: (1) multi-stock events involving 20 or more securities; and (2) transactions that trigger an individual stock trading pause by a primary listing market and subsequent transactions that occur before the trading halt is in effect for OTC trading.⁶

With respect to multi-stock events, the amended rule creates a new category—multi-stock event involving 20 or more securities—to address clearly erroneous reviews regarding executions in 20 or more securities that occur within a period of five minutes or less. Once a multi-stock event is triggered, FINRA will coordinate with the exchanges and nullify as clearly erroneous all transactions at prices equal to or greater than 30 percent away from the reference price in each affected security, consistent with the following chart (also set forth in Rule 11892 (b)(1)).

Reference Price: Circumstance or Product	Normal Market Hours (9:30 a.m. to 4 p.m. Eastern Time) Numerical Guidelines (Subject Transaction's % Difference From Reference Price):	Outside Normal Market Hours Numerical Guidelines (Subject Transaction's % Difference From Reference Price):
Greater than \$0.00 up to and including \$25.00	10%	20%
Greater than \$25.00 up to and including \$50.00	5%	10%
Greater than \$50.00	3%	6%
Multi-stock event—events involving five or more, but less than 20, securities whose executions occurred within a period of five minutes or less	10%	10%
Multi-stock event—events involving 20 or more securities whose executions occurred within a period of five minutes or less	30%, subject to the terms of paragraph (b)(2) ⁷	30%, subject to the terms of paragraph (b)(2)
Leveraged ETF/ETN securities	Normal market hours numerical guidelines multiplied by the leverage multiplier (i.e., 2x)	Normal market hours numerical guidelines multiplied by the leverage multiplier (i.e., 2x)

The amended rule also provides that FINRA will use the Trading Pause Trigger Price in an individual stock⁸ as the reference price for clearly erroneous execution reviews of: (i) the transaction that triggered a trading pause; and (ii) subsequent transactions that occur immediately after a transaction that triggered a trading pause, but before a trading halt is in effect for OTC trading, and will apply the guidelines provided in the above chart (other than the numerical guidelines applicable to multi-stock events).⁹

Both rule changes were proposed by FINRA in cooperation with the SEC and the exchanges in response to the market disruption of May 6, 2010, and are intended to address the impact of sudden price changes and provide additional parameters and transparency around reviews of potentially clearly erroneous transactions.

For more information on the individual stock trading-pause pilot, go to www.finra.org to see FINRA rule filings FINRA-2010-025 and FINRA-2010-033, and *Regulatory Notice 10-30*. For more information on the amendments to FINRA Rule 11892, see FINRA rule filing FINRA-2010-032. As stated above, the amended rules will operate on a pilot basis. If the pilot is not extended or approved as permanent by December 10, 2010, the prior versions of the rules will be in effect on December 11, 2010.

Endnotes

- 1 See Exhibit 3 of SR-FINRA-2010-033 for the pilot list of ETPs.
- 2 See Securities Exchange Act Release No. 62251 (June 10, 2010); 75 FR 34183 (June 16, 2010) (Order Approving SR-FINRA-2010-025).
- 3 See Securities Exchange Act Release No. 62883 (September 10, 2010); 75 FR 56608 (September 16, 2010) (Order Approving SR-FINRA-2010-033). On September 10, 2010, the SEC also approved similar rules by several exchanges to expand the single-stock circuit breaker pilot to Russell 1000 securities and certain ETPs.
- 4 When trading has resumed on the primary listing market at the end of the five-minute pause, OTC trading may resume immediately in that security. If a primary listing market extends the trading pause beyond the initial five-minute pause period and reopens the security at or before the end of 10 minutes, OTC trading may resume immediately at that time. In very limited circumstances, FINRA may permit the resumption of trading on the primary listing market. See *Regulatory Notice 10-30*, Question #6.
- 5 See Securities Exchange Act Release No. 62885 (September 10, 2010); 75 FR 56641 (September 16, 2010) (Order Approving SR-FINRA-2010-032). On September 10, 2010, the SEC also approved similar rule changes filed by several exchanges.
- 6 FINRA also proposed changes to Rule 11892 that, among other things, reduce the ability of FINRA to deviate from the objective standards set forth in the rule.
- 7 During multi-stock events involving 20 or more securities, FINRA will determine the appropriate review period and may use a reference price other than the consolidated last sale in its review of potentially clearly erroneous executions. Decisions made by FINRA in consultation with the exchanges during multi-stock events involving 20 or more securities are not appealable. If a security that is part of a multi-stock event also is subject to a trading pause, the trading-pause review parameters will be applied.
- 8 The Trading Pause Trigger Price is the price calculated by the primary listing market over a rolling five-minute period and may differ from the execution price of the transaction that triggered a trading pause. For example, the Trading Pause Trigger Price for a stock may be calculated as \$15.00, so that any purchases at or below \$15.00 would trigger a trading pause. However, the trade that ultimately triggers a trading pause may be executed at a price lower than the Trading Pause Trigger Price (i.e., \$14.50 in this example). FINRA will use the Trading Pause Trigger Price calculated and communicated by the primary listing market as the Reference Price for calculating clearly erroneous executions, and *not* the execution price of a transaction that triggered a trading pause.
- 9 Trades that occur when a trading halt is in effect are in violation of FINRA Rule 5260 and will be deemed clearly erroneous.

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