



DIVISION OF  
TRADING AND MARKETS

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

February 7, 2011

Janet McGinness  
Senior Vice President and Secretary  
NYSE Euronext  
20 Broad Street, 18th Floor  
New York, NY 10005

Re: Request for Exemptive Relief from Rule 201 of Regulation SHO for Single-  
Priced Opening, Reopening, and Closing Transactions  
TP File No. 11-05

Dear Ms. McGinness:

In your letter dated February 7, 2011, as supplemented by conversations with the staff of the Division of Trading and Markets ("Division"), you request that the Commission grant exemptive relief under Rule 201 of Regulation SHO<sup>1</sup> to permit the New York Stock Exchange LLC ("NYSE") and NYSE Amex LLC ("NYSE Amex") (individually, "Exchange," and collectively, the "Exchanges"), as trading centers under the Rule,<sup>2</sup> to use certain reference prices other than the current national best bid to determine whether a short sale order in a covered security that has triggered Rule 201's circuit breaker can be executed in a single-priced opening, reopening, or closing transaction executed on each Exchange under its respective rules ("single-priced transactions").<sup>3</sup> Specifically, you request that the Exchanges be permitted to execute short sale orders subject to Rule 201's short sale price test restriction in single-priced transactions if a short sale order will be executed at a price above the 9:30 a.m. national best bid, with respect to the opening transaction, or at a price above the last Exchange bid for reopening and closing transactions. Further, you represent that the Exchanges will comply with all other requirements of Rule 201 when executing single-priced transactions on the Exchanges.

Pursuant to this exemption, you represent that the Exchanges will provide data in connection with the exemption to the Commission and FINRA in the form and manner requested by Commission staff. In addition, you represent that FINRA, which provides certain regulatory

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<sup>1</sup> 17 CFR 242.201.

<sup>2</sup> A "trading center" is "a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent." See 17 CFR 242.201(a)(9); 17 CFR 242.600(b)(78).

<sup>3</sup> In your letter, you provide explanations of how single-priced transactions are generally conducted on NYSE and NYSE Amex, pursuant to each Exchange's rules. You state that these transactions are priced on the basis of orders on the Exchange and all such orders are simultaneously executed at a single determined price.

services to the Exchanges, will conduct reviews designed to identify potentially violative trading activity in connection with Rule 201 generally, and in particular the use of the alternative reference prices under Rule 201 for single-priced transactions executed on the Exchanges. Further, you represent that NYSE Regulation will notify the Commission staff of potentially violative conduct identified by FINRA.

A copy of your letter is attached to this response. By including a copy of your correspondence, we avoid having to repeat or summarize the facts you presented. The defined terms in this letter have the same meaning as in your letter, unless otherwise noted.

**Background:**

Rule 201 of Regulation SHO requires, among other things, that a trading center establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order in a covered security<sup>4</sup> at a price that is less than or equal to the current national best bid if that covered security experiences an intra-day price decline of 10% or more from its prior day's closing price.<sup>5</sup> A trading center's policies and procedures must impose this short sale price test for the remainder of the day and the following day when a national best bid is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.<sup>6</sup>

The Commission adopted the amendments to Rule 201 of Regulation SHO to prevent short selling, including potentially manipulative or abusive short selling, from further driving down the price of a security that has already experienced a significant intra-day price decline; to facilitate the ability of long sellers to sell first upon such a decline; and to help address erosions of investor confidence in our markets generally.<sup>7</sup>

You state that it would be operationally difficult for the Exchanges to use the current national best bid as a reference price in order to apply Rule 201's short sale price test to single-priced transactions executed on the Exchanges.<sup>8</sup> You represent that flickering changes to the national best bid around the time that single-priced transactions are executed could introduce instability and uncertainty to single-priced transaction processes and could cause the Exchanges

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<sup>4</sup> The term "covered security" means any NMS stock, as defined in Rule 600(b)(47) of Regulation NMS. 17 CFR 242.201(a)(1). Rule 600(b)(47) of Regulation NMS defines "NMS stock" as any NMS security other than an option. 17 CFR 242.600(b)(47). A "NMS security" is defined as any security or class of securities for which 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. 17 CFR 242.600(b)(46).

<sup>5</sup> 17 CFR 242.201(b)(1)(i).

<sup>6</sup> 17 CFR 242.201(b)(1)(ii).

<sup>7</sup> See Exchange Act Release No. 61595 (Feb. 26, 2010), 75 FR 11232, 11234 (Mar. 10, 2010) ("Rule 201 Adopting Release"). In addition to Rule 201, the Commission also adopted amendments to Rule 200(g) of Regulation SHO to provide a "short exempt" marking requirement. See *id.* The Commission extended the compliance date for the amendments to Rule 201 and Rule 200(g) of Regulation SHO from November 10, 2010 to February 28, 2011. See Exchange Act Release No. 63247 (Nov. 4, 2010), 75 FR 68702 (Nov. 9, 2010).

<sup>8</sup> See *supra* note 3.

to experience operational difficulties. In your letter, you state that a high volume of quotes across markets and greater market automation, in part due to recent changes in market structure, have contributed to flickering bids and latencies in market data feeds. Further, you note that flickering bids may make it more difficult for investors to price short sale orders for inclusion in single-priced transactions.

Absent relief, the Exchanges would be required to use the current national best bid in order to determine whether a short sale order in a covered security could be executed in a single-priced transaction, if the covered security had triggered Rule 201's circuit breaker. You represent that this requirement could create the above-noted operational difficulties, along with specific concerns with respect to single-priced opening transactions. You state that designated market makers ("DMMs") on the Exchanges manually open approximately 25% of Exchange-listed securities, which do not open algorithmically. You represent that permitting the use of the 9:30 a.m. national best bid, as a fixed reference price, would allow the DMM to quickly and efficiently determine whether short sale orders can participate in the opening transaction, since the current national best bid could continue to change before the DMM is able to execute the opening transaction. You state that, under this relief, the Exchanges would only execute short sale orders in a covered security subject to Rule 201's short sale price test if the opening transaction is at a price above the 9:30 a.m. national best bid.<sup>9</sup>

As for the proposed use of the last Exchange bid as a reference price for single-priced reopening and closing transactions, you state the belief that the last Exchange bid is a more accurate reference price than the national best bid for such transactions. Although you recognize that the last Exchange bid is often the same or within a penny or two of the national best bid, you state the belief that when they differ, the last Exchange bid is a more accurate reference price for single-priced reopening and closing transactions. In addition, you represent that for NYSE-listed and NYSE Amex-listed securities, over 99% of exchange closing volume is executed on the relevant Exchange. You state that, as a result, the reliability of the last Exchange bid would lead to more orderly and predictable reopening and closing transactions. You state that this relief would result in the Exchanges executing short sale orders in a covered security subject to Rule 201's short sale price test in reopening or closing transactions executed on the Exchanges only if such transactions are at a price above the last Exchange bid on the applicable Exchange.<sup>10</sup>

In addition, you represent that differences between the application of former Rule 10a-1<sup>11</sup> and the NASD's former bid test,<sup>12</sup> as opposed to Rule 201, help to explain why specific relief

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<sup>9</sup> In your letter, you recognize that any such execution must be in compliance with the applicable rules regarding minimum pricing increments. *See* 17 CFR 242.612; Rule 201 Adopting Release, 75 FR at 11247.

<sup>10</sup> With respect to the closing transaction, you represent that each Exchange's order entry gateway is closed at 4:00 p.m., so the last Exchange bid disseminated may be milliseconds thereafter. As for the reopening transaction, you state that the Exchanges will use the last Exchange bid prior to the regulatory or order imbalance halt, or volatility trading pause. *See also supra* note 9.

<sup>11</sup> Former Rule 10a-1 provided that, subject to certain exceptions, a listed security could be sold short (i) at a price above the price at which the immediately preceding sale was effected (plus tick), or (ii) at the last sale price if it was higher than the last different price (zero plus tick). *See* Rule 201 Adopting Release, 75 FR at 11235 – 11236.

was not provided for single-priced transactions under former short sale price tests but may be warranted under Rule 201. You note that former Rule 10a-1 was based on the last sale price, which was a fixed reference point in the context of single-priced transactions. Thus, operational concerns surrounding changes in the reference price and the potential effect on single-priced transactions were not present under former Rule 10a-1. Similarly, the NASD's former bid test benchmarked permissible short sales to the current best inside bid displayed in the NASDAQ Market Center, and NASDAQ's systems were programmed to use data to indicate the direction of the bid. You state that, in contrast to these former short sale price tests, Rule 201 operates differently and benchmarks a permissibly priced short sale against the current national best bid, which is a moving target rather than a fixed reference point.

### **Discussion:**

We believe that granting relief to allow the Exchanges to execute short sale orders in single-priced transactions if such orders are executed at a price above the 9:30 a.m. national best bid or the last Exchange bid, depending on the specific single-priced transaction, is appropriate to address operational difficulties that may result from requiring the use of the current national best bid with respect to single-priced transactions executed on the Exchanges. In adopting Rule 201, the Commission stated that the rule is narrowly tailored to strike an appropriate balance between the goal of preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security and the need to allow for the continued smooth functioning of the markets, including the provision of liquidity and price efficiency in the markets.<sup>13</sup>

The Commission also sought to limit potential impediments to the normal operation of the market when adopting Rule 201.<sup>14</sup> We recognize that the Exchanges have existing rules that are specifically designed to facilitate orderly opening, reopening, and closing transactions, which may be difficult to effectively modify to account for covered securities subject to Rule 201's short sale price test, which references the current national best bid, without otherwise impacting such markets' ability to open, reopen, or close a covered security in an orderly fashion. We further recognize that permitting the Exchanges to use the 9:30 a.m. national best bid or the last Exchange bid to determine whether short sale orders can be executed in single-priced transactions conducted on the Exchanges may help to address the Exchanges' operational concerns.

In addition, we recognize the concerns regarding the potential for a delayed opening in an Exchange-listed security if the DMM were required to use the current national best bid as a reference price with respect to manual, non-algorithmic opening transactions. We are cognizant of the importance of timely opening transactions and their contribution to fair and orderly markets. We believe that allowing the use of the 9:30 a.m. national best bid, rather than the

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<sup>12</sup> NASD's former bid test, NASD Rule 3350, prohibited short sales in NASDAQ Global Market securities (then known as NASDAQ National Market securities) at or below the current (inside) bid when the current best (inside) bid was below the previous best (inside) bid in a security. *See id.* at 11236 n.43.

<sup>13</sup> *See* Rule 201 Adopting Release, 75 FR at 11234.

<sup>14</sup> *See* Rule 201 Adopting Release, 75 FR at 11252.

current national best bid, is currently necessary in this context to limit potential impediments to the normal operation of the market. This relief is directly related to the manner in which the Exchanges currently conduct their single-priced transactions and may not be necessary or appropriate if these processes are in any way modified in the future.

Although we recognize these concerns, we are also aware that a significant percentage of trading volume is currently executed in single-priced transactions, particularly opening and closing transactions.<sup>15</sup> As such, providing exemptive relief from the requirements of Rule 201 to permit short sale orders in covered securities to be executed in these transactions if such orders are executed at a price above the 9:30 a.m. national best bid or the last Exchange bid, without regard to the current national best bid at the time of execution, may result in greater—or reduced— execution of short sale orders, depending on the circumstances. Thus, we are conditioning this exemption on the requirement that the Exchanges provide data to the Commission and FINRA related to this relief in the manner and form requested by Commission staff and that FINRA, which provides certain regulatory services to the Exchanges, conduct reviews to identify potentially violative trading activity in relation to this exemption.

Further, this relief is only being provided to the Exchanges for conducting single-priced transactions, which involve the queuing and ultimate execution of multiple orders at a single price through a formalized and transparent process. As noted above, we recognize that the Exchanges may encounter certain operational issues related to application of Rule 201 to single-priced transactions.<sup>16</sup> However, the granted relief does not affect application of the short sale price test, and trading centers' responsibilities thereto, after a covered security has triggered the circuit breaker except with respect to the reference price used under Rule 201's short sale price test to determine whether a short sale order can be executed in a single-priced transaction conducted by the Exchanges under their respective rules.<sup>17</sup> Thus, in all other respects, the Exchanges must continue to have policies and procedures reasonably designed to prevent the execution or display of a short sale order in a covered security at a price at or below the current national best bid, after Rule 201's circuit breaker has been triggered for such security, for the remainder of the day and the following day when a national best bid is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.<sup>18</sup>

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<sup>15</sup> In your letter, you state that the percentage of total trading volume executed at the open and close is approximately 25% for NYSE Amex and 15% for NYSE.

<sup>16</sup> Trading centers executing short sale orders based on the opening, reopening, or closing price determined by the primary listing market's single-priced transaction do not have these operational issues related to the application of Rule 201; thus, the relief does not extend to such trading centers. Trading centers seeking to execute short sale orders in a covered security that has triggered Rule 201's circuit breaker at the opening, reopening, or closing price, as determined by a single-priced transaction, must continue to ensure that such orders are executed in compliance with the requirements of Rule 201.

<sup>17</sup> We note that broker-dealers may not mark fully un-displayed orders, such as market on open and market on close orders, as "short exempt" in reliance on Rule 201(c). *See* Division of Trading and Markets: Responses to Frequently Asked Questions Concerning Rule 201 of Regulation SHO ("Rule 201 FAQs"), at Q&A 4.2, available at <http://www.sec.gov/divisions/marketreg/rule201faq.htm>.

<sup>18</sup> *See* Rule 201 FAQs, at Q&A 2.1 (discussing the duration of Rule 201's short sale price test restriction, once triggered).

Accordingly, we find that it is appropriate in the public interest and consistent with the protection of investors to grant an exemption from Rule 201 of Regulation SHO, on the basis of your representations, but without necessarily concurring in your analysis, to permit the Exchanges to use reference prices other than the current national best bid under Rule 201's short sale price test in determining whether a short sale order in a covered security that has triggered Rule 201's circuit breaker can be executed in a single-priced transaction conducted on the Exchange, subject to the following conditions:

- (i) The single-priced opening, reopening, or closing transactions are conducted pursuant to the Exchanges' rules or written procedures and through a formalized and transparent process;
- (ii) In determining whether a short sale order in a covered security subject to Rule 201's short sale price test can be displayed or executed, the Exchanges will continue to use the current national best bid as a reference price at all times that the short sale price test is in effect for a covered security, except as provided in this letter;
- (iii) The Exchanges will comply with all requirements of Rule 201 when executing single-priced transactions except for the specific relief provided for in this letter;
- (iv) The Exchanges will provide the Commission and FINRA with data in the form and manner requested by Commission staff;
- (v) FINRA, which provides certain regulatory services to the Exchanges, will conduct reviews to identify potentially violative trading activity in connection with the use of the 9:30 a.m. national best bid for single-priced opening transactions and the use of the last Exchange bid for reopening and closing transactions as reference prices for purposes of applying Rule 201's short sale price test to single-priced transactions executed on the Exchanges; and
- (vi) NYSE Regulation will notify the Commission staff of potentially violative conduct identified by FINRA.

The foregoing exemption from Rule 201 of Regulation SHO is based solely on the representations in your February 7, 2011 letter and the representations and facts you have presented to the staff. In the event that any material change occurs in the facts or representations in your letter, the use of a reference price other than the current national best bid in applying Rule 201's short sale price test restriction to single-priced transactions executed on the Exchanges shall be discontinued, pending presentation of the facts for our consideration. The exemption granted herein is subject to modification or revocation if at any time the Commission determines that such action is necessary or appropriate in furtherance of the purposes of the Exchange Act.

In addition, your attention is directed to the anti-fraud and anti-manipulation provisions of the Exchange Act, particularly Sections 9(a) and 10(b), and Rule 10b-5 thereunder. Responsibility for compliance with these and other applicable provisions of the federal or state securities laws must rest with participants to the transactions. The Commission expresses no view with respect to other questions that the proposed transactions may raise, including, but not limited to, the applicability of other federal and state laws to the proposed transactions.

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



James Brigagliano  
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**VIA E-MAIL & FEDERAL EXPRESS**

February 7, 2011

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U.S. Securities and Exchange Commission  
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Washington, DC 20549

Dear Mr. Brigagliano:

NYSE Euronext, on behalf of New York Stock Exchange LLC (“NYSE”) and NYSE Amex LLC (“NYSE Amex”) (individually, “Exchange,” and collectively, “Exchanges”), respectfully requests that the Securities and Exchange Commission (“SEC” or “Commission”) grant an exemption under Rule 201(f) of Regulation SHO from the short sale price test restrictions of Rule 201 in order to permit the Exchanges to use reference prices other than the current national best bid for single-priced opening, reopening, and closing transactions in their listed securities executed on the Exchanges under their respective rules (“single-priced transactions”).<sup>1</sup> Specifically, the Exchanges, as trading centers under Rule 201,<sup>2</sup> request that they be permitted to use the national best bid received by each Exchange as of 9:30 a.m. for single-priced opening transactions and the last Exchange bid for single-priced reopening and closing transactions for purposes of applying the short sale price test restriction under Rule 201, rather than the current national best bid as explicitly required by Rule 201.<sup>3</sup>

The Exchanges will provide data in connection with the proposed exemption to the Commission and FINRA in the form and manner requested by SEC staff. In addition, FINRA, which provides certain regulatory services to the Exchanges, will conduct reviews designed to identify potentially violative trading activity in connection with the short sale

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<sup>1</sup> See *infra* note 11.

<sup>2</sup> See *infra* note 7.

<sup>3</sup> The Exchanges are requesting an exemption only to permit the Exchanges to use reference prices other than the current national best bid for single-priced transactions and are not requesting an exemption for single-priced transactions from any other aspect of Rule 201. As such, all other provisions of Rule 201 would apply to single-priced transactions executed on the Exchanges in their listed securities in accordance with the Rule, any guidance issued by the Commission, and any other exemption of general applicability that may be issued by the Commission under Rule 201(f).

price test restriction generally, and in particular the use of the 9:30 a.m. national best bid and last Exchange bid reference prices for single-priced transactions, respectively, on days when the short sale price test restriction is in effect for a specific covered security. NYSE Regulation will notify the Commission staff of potentially violative conduct identified by FINRA.

Under Rule 201(f), the Commission is authorized to grant exemptions from the requirements of Rule 201, either unconditionally or on specified terms and conditions, to any person, security, or transaction, or any class thereof, to the extent that such exemption is necessary or appropriate, in the public interest, and consistent with the protection of investors.<sup>4</sup> For the reasons set forth below, the Exchanges believe that the requested exemption for single-priced transactions is necessary and appropriate, in the public interest, and consistent with the protection of investors.

#### Background on Rule 201

On February 26, 2010, the Commission adopted amendments to Rule 201 of Regulation SHO.<sup>5</sup> The amendments establish a short sale-related circuit breaker that, if triggered, imposes a restriction on the prices at which covered securities<sup>6</sup> may be sold short (“short sale price test restriction”). Among other things, Rule 201 requires that a trading center<sup>7</sup> establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from its closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.<sup>8</sup> In addition, the Rule requires that the trading center establish, maintain, and enforce written policies and procedures reasonably designed to impose this short sale price test restriction for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.<sup>9</sup> The compliance date for Rule 201 is February 28, 2011.<sup>10</sup>

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<sup>4</sup> See 17 C.F.R. § 242.201(f).

<sup>5</sup> See Exchange Act Release No. 61595 (February 26, 2010), 75 Fed. Reg. 11232 (March 10, 2010) (“Adopting Release”).

<sup>6</sup> See 17 C.F.R. § 242.201(a)(1). A “covered security” is any NMS stock, as defined in Rule 600(b)(47) of Regulation NMS. See 17 C.F.R. § 242.600(b)(47).

<sup>7</sup> See 17 C.F.R. § 242.201(a)(9). The term “trading center” has the same meaning as in Rule 600(b)(78) of Regulation NMS. See 17 C.F.R. § 242.600(b)(78). NYSE and NYSE Amex are both trading centers for purposes of Rule 201.

<sup>8</sup> See 17 C.F.R. § 242.201(b)(1)(i).

<sup>9</sup> See 17 C.F.R. § 242.201(b)(1)(ii).

<sup>10</sup> See Exchange Act Release No. 63247 (November 4, 2010), 75 Fed. Reg. 68702 (November 9, 2010).

### Single-Priced Transactions

The Exchanges' rules provide for certain single-priced transactions, which are generally described below.<sup>11</sup> These transactions represent a significant percentage of volume executed on the opening and closing of trading.<sup>12</sup> In addition, for NYSE-listed securities, over 96% of all exchange opening volume and 99% of exchange closing volume is executed on the NYSE. For NYSE Amex-listed securities, over 86% of exchange opening volume and 99% of exchange closing volume is executed on NYSE Amex.

The Exchanges' single-priced transactions are conducted in the following manner. Beginning at 7:30 a.m., NYSE and NYSE Amex systems are open to accept orders. Orders can be specifically designated with time in force as day orders or good til cancelled, or to be executed only on the opening or closing transaction. At the start of trading at 9:30 a.m., the Designated Market Maker<sup>13</sup> ("DMM") or the DMM algorithm determines the appropriate opening price for a security – a price that balances supply and demand for that security while minimizing dislocation from the previous day's closing price. Where, prior to the opening, a sizable imbalance exists between buy and sell orders that would result in a significant change in the anticipated opening price from the prior day's close, the DMM may disseminate a price range indication, based upon orders already entered on the Exchange, to solicit additional interest to minimize dislocation from the previous day's closing price. The Exchanges also disseminate a proprietary Order Imbalance Information data feed prior to the opening trade. The DMM also may add his own buy or sell interest to open the stock at an appropriate price. All executable orders in the security (all orders except those specifically designated for the close) are paired off at an equilibrium price, and executed and reported to the Consolidated Tape as one transaction.

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<sup>11</sup> See NYSE Rules 15, 80C, 116.40, 123C, and 123D; NYSE Amex Equities Rules 15, 80C, 116.40, 123C, and 123D. The descriptions of single-priced opening, reopening and closing transactions set forth in this letter are offered as illustrations, but are not exhaustive in detailing the mechanics of such transactions, except to the extent that the pricing of each such transaction is determined by orders on the Exchanges and not the prevailing quote, if any, and all such transactions are simultaneously executed at a single determined price. The exemption is requested for all single-priced openings, reopenings, and closings conducted in accordance with the rules set forth above, including delayed openings as provided for in NYSE Rules 123D and NYSE Amex Equities Rule 123D.

<sup>12</sup> The percentage of total trading volume executed at the open and close is approximately 25% for NYSE Amex and 15% for NYSE.

<sup>13</sup> Capitalized references in the sections describing single-priced transactions on each Exchange refer to defined terms in each Exchange's rules.

In the case of a reopening after a regulatory or order imbalance halt, each such reopening is preceded by a formal dissemination of a message to the Consolidated Tape, followed by a price range indication, also sent to the Consolidated Tape, reflecting orders on the Exchange.<sup>14</sup> Orders are accepted throughout a regulatory or order imbalance halt, or volatility trading pause, and are then executed by the DMM, along with orders already pending on the Exchange, at a single equilibrium price within the indicated price range. NYSE and NYSE Amex have the authority to delay reopenings if there is a significant imbalance at the end of a regulatory or order imbalance halt, or volatility trading pause.<sup>15</sup> This process helps to temper imbalances and allows the markets to reach an appropriate equilibrium price.

At the close of trading, the DMM determines the single equilibrium price by pairing off all order flow eligible for execution on the close. Such orders may be entered throughout the trading day beginning at 7:30 a.m., and include but are not limited to Market on Close (“MOC”), Limit on Close (“LOC”), Floor broker interest, and Closing Only orders. In order to come to the appropriate price on the close – pairing off the maximum volume with minimum price dislocation – Exchange systems, beginning at 3:45 p.m., disseminate significant order imbalance information to the Consolidated Tape pertaining to MOC and LOC orders. In addition, Exchange systems also distribute a proprietary Order Imbalance Information data feed pertaining to all orders eligible for inclusion in the closing transaction. To reduce imbalances and promote equilibrium prices, MOC and LOC orders can be entered after 3:45 p.m. only to offset an imbalance on the close, and MOC and LOC orders cannot be cancelled after 3:58 p.m.<sup>16</sup> All executable orders in the security are paired off against each other at an equilibrium price<sup>17</sup> and executed and reported to the Consolidated Tape as one transaction.

Under Rule 201, short sale orders in a covered security for which the short sale price test restriction was triggered during the trading day may be executed or displayed by a trading center for the remainder of the day and the following day only at a price above the current

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<sup>14</sup> A Regulatory Halt, as defined in the Consolidated Tape Association Plan, is declared, pursuant to NYSE Rule 123D and NYSE Amex Equities Rule 123D, because of news pending or news disseminated about the listed company that could significantly impact the price of the listed company’s securities. The same rules govern procedures for price dissemination prior to the resumption in trading. An order imbalance halt also is declared pursuant to NYSE Rule 123D and NYSE Amex Equities Rule 123D. A volatility trading pause is triggered if the price of a security listed on the Exchange moves by 10% or more within a five-minute period. *See* NYSE Rule 80C and NYSE Amex Equities Rule 80C. Because there may be no order imbalance in connection with a volatility trading pause, there is no requirement to disseminate Order Imbalance Information under NYSE Rule 80C or NYSE Amex Equities Rule 80C.

<sup>15</sup> *Id.*

<sup>16</sup> NYSE Rule 123C and NYSE Amex Equities Rule 123C.

<sup>17</sup> NYSE Rule 123C(8)(a)(iii) and NYSE Amex Equities Rule 123C(8)(a)(iii).

national best bid, unless the short sale order is marked “short exempt.”<sup>18</sup> Under the proposed exemption, short sale orders included in the single-priced transactions for each Exchange’s listed securities for which the short sale price test restriction was triggered would be executed only at a price above the national best bid received by each Exchange as of 9:30 a.m. for single-priced opening transactions and only at a price above the last Exchange bid for single-priced reopening and closing transactions. For example, during the trading day (Day 1), if an Exchange-listed security for which the short sale price test restriction had been triggered was halted due to a regulatory or order imbalance halt, or volatility trading pause, the Exchange would use the last Exchange bid, prior to the regulatory or order imbalance halt, or volatility trading pause, as the reference price above which short sale orders may be executed in the single-priced reopening transaction. Short sale orders would not participate in the reopening transaction if the reopening transaction was priced at or below the last Exchange bid. Similarly, short sale orders in an Exchange-listed security for which the short sale price test restriction had been triggered would participate in the single-priced closing transaction on the Exchange only if the closing transaction was priced above the last Exchange bid.<sup>19</sup> On Day 2, the short sale price test restriction would still be in effect; therefore, under the proposed exemption, short sale orders in an Exchange-listed security for which the short sale price test restriction had been triggered would participate in the single-priced opening transaction only if the opening transaction was priced above the national best bid received in Exchange systems at 9:30 a.m. During the trading day on Day 2, short sale orders would participate in reopening and closing transactions as described above.

As explained above, if a reopening or closing transaction was priced at or below the last Exchange bid, or if an opening transaction was priced at or below the national best bid received in Exchange systems at 9:30 a.m., short sale orders would not participate in these single-priced transactions. Short sale orders that do not participate in the single-priced transactions may be cancelled or left on the Exchanges’ books to be executed after the single-priced transactions, depending on the order type and in accordance with the Exchanges’ applicable rules and Rule 201. Pursuant to the Exchanges’ proposed rules to implement Rule 201, short sale orders that are Immediate or Cancel or Intermarket Sweep Orders will be rejected if they cannot be immediately executed. In addition, short sale orders entered with specific designations for execution only in the opening or closing transaction that remain unexecuted in that transaction, for whatever reason, will be cancelled.

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<sup>18</sup> See 17 C.F.R. § 242.201(b)(1). Rule 201 does not specify a particular increment above the national best bid at which a covered security may be sold short. However, any execution or display of a short sale order pursuant to Rule 201 must be in compliance with applicable rules regarding minimum pricing increments. See Adopting Release at 11247; 17 C.F.R. § 242.612.

<sup>19</sup> Each Exchange’s order entry gateway is closed at 4:00 p.m., so the last Exchange bid disseminated may be milliseconds thereafter.

### Rationale for Proposed Alternative Reference Prices for Single-Priced Transactions

The Exchanges request that the Commission grant an exemption from Rule 201 that would permit each Exchange to use as a reference price the national best bid received by it as of 9:30 a.m. for single-priced opening transactions and the last Exchange bid for single-priced reopening and closing transactions for purposes of applying the short sale price test restriction under Rule 201, rather than the current national best bid as explicitly required by Rule 201. The Exchanges believe that flickering changes to the current national best bid around the time that single-priced transactions are executed could cause the Exchanges to experience operational difficulties and introduce instability and uncertainty to single-priced transaction processes.

For example, under former SEC Rule 10a-1, the pricing of a permissible short sale was benchmarked to the last sale price;<sup>20</sup> in the context of single-priced transactions, this provided a fixed target against which to determine the permissible price of a short sale. Similarly, under former NASD Rule 3350, permissible short sales were benchmarked to the current best inside bid displayed in the NASDAQ Market Center, and NASDAQ's systems were programmed to use data readily available to it to indicate the direction of the bid at all times. In contrast, Rule 201 operates differently from both of those former rules and benchmarks a permissible short sale against the current national best bid, which is subject to potentially frequent and rapid change (i.e., a moving target). As the Commission has acknowledged in the Adopting Release for Rule 201, flickering bids and latencies in market data feeds may create confusion in determining whether a short sale is executed at a permissible price.<sup>21</sup> This issue is exacerbated by recent changes in market structure, which include greater automation of executions and a high volume of quotes across markets.<sup>22</sup> In addition, flickering bids may make it more difficult for investors to price short sale orders for inclusion in either opening or closing transactions. For these reasons, the Exchanges believe that it would be impractical in

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<sup>20</sup> Single-priced transactions were not exempt from former SEC Rule 10a-1 (for exchange-listed stocks) and former NASD Rule 3350 (for NASDAQ stocks). However, under former Rule 10a-1(a)(2), an exchange could, by rule, require the use of its last sale price as the benchmark for a permissible short sale rather than the last sale price disseminated by the Consolidated Tape. The NYSE and NYSE Amex adopted such rules while former Rule 10a-1 was in effect. *See* Exchange Act Release No. 12201 (March 12, 1976), 41 Fed. Reg. 11907 (March 22, 1976) (approving NYSE Rule 440B); Exchange Act Release No. 12357 (April 21, 1976), 41 Fed. Reg. 17633 (April 27, 1976) (approving amendments to Amex Rule 7). Former Rule 10a-1 was eliminated in 2007. *See* Exchange Act Release No. 55970 (June 28, 2007), 72 Fed. Reg. 36348 (July 3, 2007); *see generally* Adopting Release at 11235-11237.

<sup>21</sup> *See* Adopting Release at 11261-11262.

<sup>22</sup> During an 11-day period in the fourth quarter of 2010, new quotes in NYSE-listed securities were displayed on average 3.3 times per second and in NYSE Amex-listed securities 0.4 times per second, with new quote traffic spiking on the close. The high in an individual symbol during this period was 89 quotes per second on NYSE and 26 quotes per second on NYSE Amex. These numbers reflect new quote messages, not necessarily changes to the national best bid. The average stock across all markets had 16 quotes at 9:30 a.m. and 28 quotes at 4:00 p.m. over that 11-day period. Source: Consolidated Quotation System.

today's market structure to utilize the current national best bid to determine permissible short sales in the context of single-priced transactions executed on the Exchanges, during which the Exchanges may experience the highest levels of quoting and trading activity of the trading day.

With respect to the single-priced opening transaction, DMMs must manually open stocks that do not open algorithmically, which is about 25% of Exchange-listed securities. Permitting the Exchange to use a fixed benchmark, i.e., the national best bid received at 9:30 a.m., allows the DMM to quickly and efficiently determine whether short sales can participate in the opening transaction, even if the current national best bid changes after 9:30 a.m. but before the DMM can execute the single-priced transaction. If the proposed exemption is granted, in the interest of transparency, the Exchange will include a new field showing the permissible price for short sales for the opening as part of the Order Imbalance Information data feed that it currently disseminates.<sup>23</sup>

With respect to single-priced reopening and closing transactions, the requested reference price is the last Exchange bid. While the last Exchange bid is often the same or within a penny or two of the national best bid, when it differs, the Exchanges believe that the last Exchange bid is a more accurate reference price than the national best bid for such transactions.<sup>24</sup> As noted above, for NYSE-listed securities, over 99% of exchange closing volume is executed on the NYSE, and for NYSE Amex-listed securities, over 99% of exchange closing volume is executed on NYSE Amex. Thus, the reliability of the last Exchange bid would lead to more orderly and predictable reopening and closing transactions. The Exchanges note that there is precedent for permitting an exchange to utilize its own static reference price for application of a short sale price test restriction. Under former Rule 10a-1(a)(2), an exchange could, by rule, require the use of its last sale price as the benchmark for a permissible short sale rather than the last sale price disseminated by the Consolidated Tape.<sup>25</sup> Because the proposed reference prices are the last Exchange bids immediately before the reopening and closing transactions, the Exchanges believe that they are sufficiently close in time and current as reference prices.

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<sup>23</sup> The permissible price is one increment above the national best bid at 9:30 a.m. *See supra* note 18. While the last Exchange bid before reopening or closing transactions is a static price generally available to the market, the national best bid at 9:30 a.m. may be less easily discerned. For this reason, the permissible price for opening transactions will be included in the Order Imbalance Information data feed, while the permissible price for reopening and closing transactions will not be disseminated in the data feed.

<sup>24</sup> The consensus view of a number of Exchange member organizations is that the last Exchange bid would be a more accurate reference price than the national best bid.

<sup>25</sup> *See supra* note 20.

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For these reasons, the Exchanges believe that it is necessary and appropriate, in the public interest, and consistent with the protection of investors for the Commission to grant an exemption under Rule 201(f) from the short sale price test restrictions imposed by Rule 201 in order to permit the Exchanges to use the proposed alternative reference prices described above rather than the current national best bid in applying the requirements of Rule 201 to single-priced transactions executed on each Exchange. The Exchanges believe that the proposed exemption would avoid the operational difficulties noted above while still preserving the essential goals of Rule 201 by preventing short selling, including potentially manipulative or abusive short selling, from driving down the price of a security that has already experienced a significant intra-day price decline.

If you have any questions regarding this request for an exemption, please contact Karen Lorentz at 212-656-5858 or Mary Dunbar at 202-739-5358.

Very truly yours,



cc: The Honorable Mary L. Schapiro, Chairman  
The Honorable Elisse B. Walter, Commissioner  
The Honorable Kathleen L. Casey, Commissioner  
The Honorable Luis A. Aguilar, Commissioner  
The Honorable Troy A. Paredes, Commissioner  
Robert W. Cook, Director, Division of Trading and Markets  
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