SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55884)

June 8, 2007

Order Exempting Certain Error Correction Transactions from Rule 611 of Regulation NMS under the Securities Exchange Act of 1934

I. Introduction

Pursuant to Rule 611(d)[1] of Regulation NMS[2] under the Securities Exchange Act of 1934 ("Exchange Act"), the Securities and Exchange Commission ("Commission"), by order, may exempt from the provisions of Rule 611 of Regulation NMS ("Rule 611" or "Rule"), either unconditionally or on specified terms and conditions, any person, security, transaction, quotation, or order, or any class or classes of persons, securities, quotations, or orders, if the Commission determines that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.[3] As discussed below, the Commission is exempting from Rule 611(a) certain transactions to correct bona fide errors in the execution of customer orders, subject to specified conditions discussed below. The exemption is designed to promote efficiency and the best execution of investor orders by allowing trading centers to correct bona fide errors in a manner consistent with their customers' orders, without the trading centers incurring additional costs to meet the requirements of Rule 611(a).

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1 17 CFR 242.611(d).

2 17 CFR 242.600 et seq.

3 See also 15 U.S.C. 78mm(a)(1) (providing general authority for the Commission to grant exemptions from provisions of the Exchange Act and rules thereunder).

II. Background

The Commission adopted Regulation NMS in June 2005.[4] Rule 611 addresses intermarket trade-throughs of displayed quotations in NMS stocks. Rule 611(a)(1) requires a trading center to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs on that trading center of protected quotations in NMS stocks that do not fall within an exception set forth in the Rule. Rule 611(b)(6) provides an exception for a trade-through transaction effected by a trading center that simultaneously routes an intermarket sweep order ("ISO") to execute against the full displayed size of any protected quotation in the NMS stock that was traded through. Rule 611(b)(5) provides an exception for a trade-through transaction that is an execution of an ISO. Finally, Rule 611(c) requires that the trading center, broker, or dealer responsible for the routing of an ISO take reasonable steps to establish that such order meets the definition of an ISO in Rule 600(b)(30).[5]

The Trading Committee of the Securities Industry and Financial Markets Association ("SIFMA") has requested that the Commission exempt certain error correction transactions from Rule 611(a).[6] According to the SIFMA Exemption Request, error correction transactions are the mechanism through which broker-dealers remedy the execution of customer orders that have been placed in error or mishandled due to an error involving any term of an order, including, for example, price, number of shares, identification of the security, or execution of a transaction on the wrong side of the market.[7] In addition, the SIFMA Exemption Request noted that, given the

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4 See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) ("Regulation NMS Adopting Release").

5 17 CFR 242.600(b)(30).

6 Letter to Nancy M. Morris, Secretary, Commission, from Jerry O'Connell, Chairman, SIFMA Trading Committee, dated May 1, 2007 ("SIFMA Exemption Request").

7 Id. at 2.

high level of automation in today's marketplace, errors often result from delays, outages, or other failures of communications systems used in the delivery or execution of an order. Broker-dealers typically remedy such bona fide errors by entering a subsequent trade on behalf of the customer on the correct terms of the original order. In the interim, however, the market prices for a security may have moved, and the subsequent error correction transaction may be effected at a price that is no longer within the national best protected bid and offer.[8]

According to the SIFMA Exemption Request, broker-dealers seeking to execute error corrections, if required to comply with Rule 611, would need to satisfy all better-priced protected quotations prior to effecting the error correction transaction.[9] Although some error correction transactions that are "underwater" within the meaning of the stopped order exception in Rule 611(b)(9) could qualify for such exception, the SIFMA Exemption Request states that there are many instances in which bona fide errors need to be remedied, but may not meet the definition of an underwater trade. The inability of broker-dealers to correct all bona fide errors in a manner consistent with a customer's original order without incurring additional expense would impede the effective correction of trading errors. As a result, SIFMA believes that all bona fide error correction transactions, including those not underwater, merit a specific exemption from Rule 611.[10]

The SIFMA Exemption Request states that the benefits of the requested exemption would far outweigh any disadvantages.[11] The exemption would facilitate the ability of broker-dealers to provide fair remediation to customers who otherwise would suffer economic consequences as a

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8 Id.

9 Id.

10 Id.

11 Id. at 5.

result of inadvertent mistakes or system failures. Also, the SIFMA Exemption Requests asserts that the number of bona fide error correction transactions is likely to be small in comparison to the total number of trades executed in NMS stocks, so that the number of exempted trade-throughs would not unduly detract from the objectives of Rule 611.[12]

III. Discussion

The Commission has decided to exempt trading centers from the requirement in Rule 611(a) to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs when the transaction that constituted the trade-through meets the following terms and conditions ("Error Correction Transaction"):

(1) The trading center effects the transaction solely to correct a "bona fide error,"[13] which is defined as: (i) the inaccurate conveyance or execution of any term of an order including, but not limited to, price, number of shares or other unit of trading; identification of the security; identification of the account for which securities are purchased or sold; lost or otherwise misplaced order tickets; short sales that were instead sold long or vice versa; or the execution of an order on the wrong side of a market; (ii) the unauthorized or unintended purchase, sale, or allocation of securities, or the failure to follow specific client instructions; (iii) the incorrect entry of data into relevant systems, including reliance on incorrect cash positions, withdrawals, or securities positions reflected in an account; or (iv) a delay, outage, or failure of a

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12 Id. at 5.

13 The exemption solely addresses the status of a transaction under Rule 611. It presumes that the trading center has complied with all requirements applicable to error transactions, including SRO rules.

communication system used to transmit market data prices or to facilitate the delivery or execution of an order.[14]

(2) The bona fide error is evidenced by objective facts and circumstances, and the trading center maintains documentation of such facts and circumstances;

(3) The trading center records the transaction in its error account;

(4) The trading center establishes, maintains, and enforces written policies and procedures that are reasonably designed to address the occurrence of errors and, in the event of an error, the use and terms of a transaction to correct the error in compliance with this exemption; and

(5) The trading center regularly surveils to ascertain the effectiveness of its policies and procedures to address errors and transactions to correct errors and takes prompt action to remedy deficiencies in such policies and procedures.

The exemption applies only to the Error Correction Transaction itself. It does not, for example, apply to any subsequent trades effected by a trading center to eliminate a proprietary position connected with the Error Correction Transaction.

The Commission believes that an exemption for Error Correction Transactions is appropriate to promote efficiency and the best execution of investor orders.[15] The exemption will allow trading centers to execute Error Correction Transactions at the appropriate prices to

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14 Absent a bona fide error as defined above, the exemption does not apply to a broker-dealer's mere failure to execute a not-held order in accordance with a customer's expectations.

15 See Exchange Act Section 11A(a)(1)(C)(i) and (iv) (assuring efficient execution of securities transactions and the practicability of executing investors' orders in the best market are two of the primary objectives for the national market system).

correct bona fide errors without a requirement to prevent trade-throughs of the current protected quotations or to qualify for one of the exceptions in Rule 611(b). It thereby will minimize the expense incurred by trading centers to remedy certain errors in a manner consistent with their customers' orders.

In addition, the terms of the exemption are designed to minimize the potential for abuse, such as claiming its applicability to transactions other than those to correct bona fide errors. For example, a bona fide error must be evidenced by objective facts and circumstances, and the trading center must document such facts and circumstances. A trading center must record the Error Correction Transaction in an error account and implement policies and procedures that reasonably address errors and the use of Error Correction Transactions. A trading center's use of the exemption therefore should be readily reviewable by the applicable regulatory authorities.

Finally, Error Correction Transactions should represent a very small percentage of the total number of trades in NMS stocks. The exemption therefore should not significantly detract from the policy objectives of Rule 611.

For the foregoing reasons, the Commission finds that granting the foregoing exemption is necessary and appropriate in the public interest, and is consistent with the protection of investors.

IV. Conclusion

IT IS HEREBY ORDERED, pursuant to Rule 611(d) of Regulation NMS, that trading centers shall be exempt from the requirement in Rule 611(a) to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs when the transaction that constituted the trade-through qualifies as an Error Correction Transaction, as defined above.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[16]

Florence E. Harmon
Deputy Secretary

[16] 17 CFR 200.30-3(a)(82).