

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54678)

October 31, 2006

Order Exempting Certain Sub-Penny Trade-Throughs from Rule 611 of Regulation NMS under the Securities Exchange Act of 1934

I. Introduction

Pursuant to Rule 611(d)¹ of Regulation NMS² 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 trading centers executing transactions that trade through a low-priced protected quotation by less than \$0.01 per share. The exemption is designed to promote more workable and efficient intermarket price priority in NMS stocks with quoted prices of \$1.00 or less per share that can be quoted in increments as small as \$0.0001.

II. Background

The Commission adopted Regulation NMS in June 2005.⁴ Rule 611(a)(1) requires a trading center to establish, maintain, and enforce written policies and procedures that are

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 Commission to grant exemptions from provisions of Exchange Act and rules thereunder).

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

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 that was traded through.

Rule 612(a) of Regulation NMS prohibits, among other things, the display of quotations priced in an increment smaller than \$0.01 if the quotation is priced equal to or greater than \$1.00 per share.⁵ Under Rule 612(b), however, it is permissible to display quotations in increments as small as \$0.0001 if the quotation is priced less than \$1.00 per share. As a result, quotations priced in increments as small as \$0.0001 could qualify as “protected quotations” under Rule 600(b)(58).⁶

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: (1) the price of the protected quotation that is traded through is \$1.00 or less; and (2) the price of the trade-through transaction is less than \$0.01 away from the price of the protected quotation that was traded through (“Sub-Penny Trade-Throughs”).

⁵ 17 CFR 242.612(a).

⁶ 17 CFR 242.600(b)(58). A “protected quotation” is defined as a protected bid or protected offer. Under Rule 600(b)(57), a “protected bid” or “protected offer” means a quotation in an NMS stock that: (i) is displayed by an automated trading center; (ii) is disseminated pursuant to an effective national market system plan; and (iii) is an automated quotation that is the best bid or best offer of a national securities exchange or a national securities association.

The Commission believes that granting an exemption for Sub-Penny Trade-Throughs will promote a more workable and efficient trade-through rule in NMS stocks that can be priced in very small increments of less than \$0.01. The Regulation NMS Adopting Release notes that implementation of the Rule 611 trade-through provisions is likely to present the greatest challenge for agency markets trading active stocks that handle a large volume of buy and sell orders.⁷ These trading centers must assure that such orders interact in an orderly and efficient manner in compliance with all applicable priority rules. The Rule 611(a) requirement of written policies and procedures is designed to achieve the objective of eliminating all trade-throughs that reasonably can be prevented, while also acknowledging the inherent difficulties of eliminating trade-through transactions in active stocks with quotations that change rapidly.⁸

Consistent with this approach, the Commission is adopting an exemption for Sub-Penny Trade-Throughs, particularly to allow active agency trading centers that continuously display quotations and execute orders against such quotations to operate their trading systems efficiently in stocks that can be quoted in increments of as small as \$0.0001. Given these small quoting increments for protected quotations priced at less than \$1.00 per share, the Commission does not believe it is appropriate to require trading centers to prevent trade-throughs of less than \$0.01. In the absence of an exemption, trading centers generally would be required to prevent the execution of incoming orders against their own displayed quotations with prices that could be only \$0.0001 away from a protected quotation displayed by another trading center. The Commission does not believe that the very small economic benefit to be gained by protecting such a quotation would justify the practical difficulties faced by trading centers in operating their trading systems efficiently.

⁷ 70 FR at 37524.

⁸ 70 FR at 37534.

For the foregoing reasons, the Commission finds that granting an exemption for Sub-Penny Trade-Throughs 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: (1) the price of the protected quotation that is traded through is \$1.00 or less; and (2) the price of the trade-through transaction is less than \$0.01 away from the price of the protected quotation that was traded through.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Nancy M. Morris
Secretary

⁹ 17 CFR 200.30-3(a)(82).