

MEMO# 23858

October 8, 2009

SEC Approves Exchange Rules for Erroneous Trades

[23858]

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 40-09
ETF ADVISORY COMMITTEE No. 31-09 RE: SEC APPROVES EXCHANGE RULES FOR
ERRONEOUS TRADES

The Securities and Exchange Commission has approved a series of “model” rules for breaking “clearly erroneous” stock trades across the U.S. equities markets. [\[1\]](#) According to the SEC, the model rules, which became effective on October 5, 2009, provide a uniform standard across the equities markets to eliminate the problems stemming from application of the prior inconsistent and subjective rules, particularly during times of extraordinary market volatility.

Numerical Guidelines

The model rules allow an exchange to consider breaking a trade only if the price exceeds the consolidated last sale price – i.e., the reference price, by more than a specified percentage amount (“numerical guidelines”): 10% for stocks priced under \$25 (20% for pre-opening or after hours trading sessions); 5% for stocks priced between \$25 and \$50 (10% for pre-opening or after hours trading sessions); and 3% for stocks priced over \$50 (6% for pre-opening or after hours trading sessions). A request for breaking a trade involving five or more securities by the same exchange member will be aggregated into a “multi-stock event” with a threshold of 10% for regular, pre-trading, or after hours trading sessions. For leveraged ETFs, the guidelines must be multiplied by the leverage multiplier of the security. Executions that do not meet or exceed the numerical guidelines will not be eligible for review. [\[2\]](#)

The model rules permit exchanges to use a reference price other than the consolidated last sale price for unusual circumstances including periods of extreme market volatility, sustained liquidity, or widespread systems issues. Other reference prices include the consolidated inside price, the consolidated opening price, the consolidated prior close, or the consolidated last sale prior to a series of executions. An exchange also will have the ability to use a different reference price or numerical guideline in the case of events that involve other markets – in an effort to achieve consistency across markets. In addition, an exchange may use a higher numerical guideline if, after market participants have been alerted to erroneous activity, the price of the security returns toward its prior trading range but continues to trade beyond the price it would have normally been broken. It may use a lower numerical guideline with respect to system disruptions and malfunctions if necessary to maintain a fair and orderly market, protect investors, and protect the public interest.

Process for Filing and Acting on a Request to Break a Trade

Under the model rules, the erroneous trade review process generally must commence within 30 minutes of the trade, and be resolved within 30 minutes thereafter, but in no case later than the start of regular trading on the following trading day. [\[3\]](#) In the case of an execution routed from an initial market center to another exchange, the initial market center may have an additional 30 minutes from the receipt of its participant's timely filing to request a ruling but no longer than 60 minutes from the time of the execution under review. The rules also permit consideration of a request for review received after 30 minutes, but no longer than 60 minutes, in the case of outlier transactions, described as transactions where the execution price of the security is greater than three times the current numerical guidelines.

At this time, requests for review must be made by email and must include the factual basis for the request. [\[4\]](#) The exchange will notify the counterparty to a trade only upon receipt of a timely filed request for review that satisfies the numerical guidelines set forth in the rule. In addition, an officer of the exchange or other employee designee may request additional information from each party to a transaction under review, to which the parties will have 30 minutes to provide additional supporting information. In considering a request, an officer or employee designee may consider factors including, for example, systems malfunctions or disruptions, volume and volatility for the security, whether the security is an initial public offering, validity of the consolidated tapes' trades and quotes, and executions inconsistent with the trading pattern in the stock. The officer or employee designee may only break the trade or let it stand; modification of the trade is not permitted.

Appeals from a request to break a trade also must be made via email, and will be reviewed as soon as practicable, but generally on the same day. Appeals made between 3 p.m. Eastern Time and the close of trading of the after hours session will be reviewed as soon as practicable, but in no case later than the trading day following the date of the execution under review. Decisions will be rendered without prejudice to avoid limiting or impeding the rights of the parties to arbitrate their dispute.

The rules clarify that a transaction made in clearly erroneous error and agreed to be canceled by both parties or determined by the exchange to be clearly erroneous will be removed from the consolidated tape only when the determination is deemed final and any applicable appeals have been exhausted.

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endnotes

[1] See SEC Approves New Exchange Rules for Breaking Clearly Erroneous Trades, SEC Press Release 2009-215, October 5, 2009. The following exchanges have adopted the model rules as approved by the SEC: BATS Exchange, Chicago Board Options Exchange, Chicago Stock Exchange, International Securities Exchange, NASDAQ Stock Market, NASDAQ OMX BX, National Stock Exchange, NYSE Amex, and NYSE Arca.

[2] The rules would permit an exchange to expand the numerical guidelines to a volatile market open as determined based on the value of the S&P 500 Futures at 9:15 a.m. Specifically, when S&P Futures are up or down from 3% up to but not including 5%, the numerical guidelines are doubled; for greater than 5%, the guidelines are tripled.

[3] Rulings made outside of 30 minutes will not fail for lack of timeliness.

[4] The rules will permit an officer or employee designee to act on his or her own motion to review potentially erroneous executions under any circumstances.