

Information Memo



Number 12-16
June 15, 2012

TO: ALL NYSE AND NYSE MKT MEMBERS AND MEMBER ORGANIZATIONS
FROM: NYSE REGULATION
SUBJECT: RUSSELL RECONSTITUTION – JUNE 22, 2012

**IMPORTANT – READ IN ENTIRETY
 PLEASE SHOW TO YOUR COMPLIANCE OFFICER
 AND HEAD OF TRADING OPERATIONS**

I. Purpose

Following the close of trading on June 22, 2012, the Russell Investment Group will reconstitute certain of its indices, including the Russell 3000[®] Index and the Russell Microcap[®] Index. This reconstitution may significantly affect the volume of trading on the New York Stock Exchange LLC (“NYSE”) and NYSE MKT LLC (“NYSE MKT”) (collectively, the “Exchange”), particularly leading into the close on June 22.

This Information Memorandum reminds members and member organizations of certain Exchange Rules and policies regarding:

- entry and cancellation of market-on-close/limit-on-close (“MOC/LOC”) and Closing Offset (“CO”) orders;
- publication of on-the-close imbalances; and
- printing the closing transaction.

This memorandum also provides guidance on possible system interruption scenarios and the operation of certain Exchange Rules and policies in the event that such a scenario occurs.

II. Background

Reconstitution of certain Russell Indexes will take effect after the close of U.S. equity markets on June 22, 2012. On June 8, 2012, the Russell Investment Group published a preliminary list of additions and deletions to the Russell 3000[®] and Microcap[®] Indexes. The Exchange expects that during the trading day on June 22, and especially at or near the Close, significant trading volume associated with portfolio rebalancing will be initiated based upon those lists. Based on the preliminary lists, 122 NYSE-listed stocks and 68 NYSE MKT-listed stocks will be added to or deleted from the indices, though more stocks could be impacted by the reconstitution.

III. Exchange Rules and Policies Relating to the Close

- a. MOC/LOC and CO Order Entry and Cancellation

Exchange Rule 123C (Closing Procedures) applies to the close on June 22, subject to the contingency scenarios outlined below in the event of a systems outage. In addition, although certain categories of

imbalance publications (such as Informational Imbalances) require prior Floor Official approval, given the number of imbalance publications expected and the sensitivity surrounding the Close on June 22, DMMs are encouraged to consult with and receive the approval of a **Senior Floor Official or higher**.

While the Exchange expects its systems to operate normally on June 22, in the unlikely event of a systems interruption leading into or at the Close, the Closing Procedures set out in Exchange Rule 123C would apply in the event the Exchange declared a regulatory halt in one or more securities. In the event that one or both marketplaces invokes exemptive powers under Exchange Rule 123C(9) (Closing Procedures - Extreme Order Imbalances at or Near the Close), the terms of that rule would govern the handling of orders at the Close. See Section d below.

In connection with the entry of MOC/LOC and CO orders generally, members and member organizations should pay particular attention to the following:

- A “published imbalance” is an imbalance that has been disseminated to the Tape. An imbalance that is announced orally or physically posted at the panel is not considered to be a published imbalance. The Exchange Order Imbalance Information product, a data feed of real-time order imbalances that accumulate prior to the opening of trading on the Exchange and prior to the close of trading on the Exchange, does not constitute a “published imbalance.”
- Brokers and traders are reminded that, while they should enter orders as early in the day as possible, all MOC/LOC orders (unless to offset a published imbalance) must be entered by 3:45 p.m.¹
- Entering MOC/LOC orders early provides DMMs with the opportunity to more quickly identify potential order imbalances that might exist at the Close and to disseminate that information. This, in turn, enables brokers and traders to more effectively identify potential offsetting customer interest that could mitigate any imbalance. MOC/LOC and CO orders entered prior to 3:45 p.m. may be canceled or reduced prior to that time for any reason.
- After 3:45 p.m., MOC/LOC orders may be entered only to offset a security’s published imbalance, while CO orders may be entered in any amount on either side of the market. During this time period, MOC/LOC and CO orders may be canceled or reduced in size only to correct a legitimate error.² This also applies to instances where cancel/replace functionality is used. Please note that FINRA will continue to closely monitor the cancellation of MOC/LOC and CO orders pursuant to Exchange Rules.
- After 3:58 p.m., MOC/LOC and CO orders may not be cancelled or reduced in size for any reason, except in accordance with Exchange Rule 123C(9).
- In the event of a trading halt effective at 3:45 p.m. or later, MOC/LOC orders may be entered only to offset a published imbalance. CO orders, however, may be entered in any amount on either side of the market. See Exchange Rule 123C(2)(c).

¹ Exchange systems accept only those MOC/LOC orders entered after 3:45 p.m. that are on the contra side of a published regulatory imbalance and reject all cancel requests sent after 3:58 p.m. for any previously entered MOC/LOC order.

² A “legitimate error” is an error in the term of an order, such as price, number of shares, buy/sell, or identification of the security. See Exchange Rule 123C(1)(c).

b. Imbalance Publications³

Exchange Rule 123C(5) provides for the publication of order imbalances as described below. In the event of a system interruption, the times and requirements listed here may change.

1. Informational Imbalance Publications between 3:00 p.m. and 3:45 p.m.

Between 3:00 p.m. and 3:45 p.m., DMMs are encouraged to issue Informational Imbalance Publications of any size if they believe that there could be significant price dislocation at the Close. These publications are informational only and do not limit MOC/LOC or CO order entry or cancellation before 3:45 p.m. DMMs who wish to issue Informational Imbalance Publications must obtain prior approval from a Floor Official or qualified Exchange employee (see Exchange Rule 46.10) prior to issuance. As volume may be greater than normal on June 22, 2012, DMMs should issue Informational Imbalance Publications as early as possible.

2. Mandatory MOC/LOC Imbalance Publications at 3:45 p.m.

As soon as practicable after 3:45 p.m., Exchange systems will publish any MOC/LOC imbalance of 50,000 shares or more for NYSE-listed securities and 25,000 shares or more for NYSE MKT listed securities. Other significant imbalances of lesser size (e.g., less than 50,000/25,000 shares but significant relative to the average daily trading volume (“ADTV”) of a particular security) may be published by the DMM with Floor Official or qualified Exchange employee approval.⁴ In addition, any Informational Imbalance Publication issued prior to 3:45 p.m. must be updated at 3:45 p.m. Exchange systems will publish an imbalance of 50,000 shares (NYSE), 25,000 shares (NYSE MKT) or more. If there is an imbalance of any lesser size that is significant relative to the ADTV of the stock, it may be published by the DMM with prior Floor Official or qualified Exchange employee approval. If there is no such imbalance, a “no imbalance” indication must be issued by the DMM.

3. Mandatory MOC/LOC Imbalance Publications after a Trading Halt

If a trading halt is in effect at 3:45 p.m. but is lifted prior to the Close, MOC/LOC imbalances of 50,000 shares (NYSE), 25,000 shares (NYSE MKT), or more will be published by the DMM as soon as possible after the resumption of trading. Additionally, any imbalance of lesser size if significant relative to the ADTV may be published by the DMM as soon as possible after trading reopens, subject to prior Floor Official or qualified Exchange employee approval. If the trading halt is not lifted before the Close, there will not be any imbalance publications.

4. Exchange Publication of Order Imbalance Information

In addition to the Informational Imbalance and Mandatory MOC/LOC Imbalance Publications described above, the Exchanges also make available real-time Order Imbalance Information prior to the Close in

³ Imbalance publications include both MOC and marketable LOC orders (based on the last sale price at the time the publication is made). See Exchange Rule 123C(1)(b) and (d), defining “Informational Imbalance Publications” and “Mandatory MOC/LOC Imbalance Publications”. For more information on how imbalance publications are calculated, see Exchange Rule 123C(4).

⁴ As with Informational Imbalance Publications, Floor Official approvals to issue certain Mandatory MOC/LOC Imbalance Publications must be recorded on the Floor Official Approval Form under Item 12 (“Consultation/Other”). Members must state the proposed imbalance information and note any other relevant information (e.g., ADTV, size, degree of impact) in connection with the request.

accordance with Exchange Rule 123C(6). These publications take place approximately every five (5) seconds between 3:45 p.m. and 4:00 p.m. The Order Imbalance Information publications use a reference price (see Exchange Rule 123C(6)(a)(iii)) in order to indicate how many shares would be needed to close the security at that price, including MOC, marketable LOC and CO orders.⁵ Beginning at 3:55 p.m., the Order Imbalance Information publications also include stop orders, d-Quotes and all other e-Quotes containing pegging instructions eligible to participate in the closing transaction.⁶

As noted above, Order Imbalance Information publications are solely for informational purposes and off-setting interest must not be submitted in response to Order Imbalance Information publications. Off-setting MOC/LOC interest may be submitted only as described in this memo in response to a Mandatory MOC/LOC Imbalance Publication issued at 3:45 p.m. or after a trading halt in accordance with Rule 123C(2).

c. Printing the Closing Transaction

1. Exchange Rules 116.40 and 123C(8)

DMMs are reminded that the closing transaction must be printed consistent with Exchange Rules 116.40 and 123C(8) and must accurately reflect both the closing price and closing volume when printing the closing transaction.⁷ Additionally, DMMs are reminded of their obligation to maintain a fair and orderly market pursuant to Rule 104.

2. Verbal Interest and e-Quotes at the Close

DMMs should take all interest, including verbal, e-Quoted and Display Book interest, into account when formulating the Close. Depending on whether it is marketable or not, verbal interest may be handled differently than e-Quoted interest at the Close. Marketable verbal interest is included with all market and MOC interest at the Close, while limited verbal interest and e-Quotes are on parity with limit orders. DMMs are reminded that verbal interest from a Floor broker should be handled one of two ways: entered into GTM by NYSE Operations staff or into the crowd field of the Closing template by the DMM.

Pursuant to Rule 342, members and member organizations must ensure that they have adequate written policies, procedures and controls in place to detect, deter and prevent conduct inconsistent with the guidance set forth above. Any member who believes that the above procedures have not been adhered to should report his or her concern to the FINRA On-Floor Surveillance Unit.

3. Orders to Offset MOC/LOC Imbalances at the Close to Mitigate Price Disparity

Exchange Rule 902 (Off Hours Trading Orders) provides for entry of orders after the Close. Rule 902(a)(ii)(B) permits DMMs to include in the calculation of the Close legitimate market interest that has agreed to offset all or part of any MOC imbalance that existed prior to the Close at 4:00 p.m. The

⁵ In the case of a buy (sell) imbalance, CO orders to sell (buy) at a price equal to or lower (higher) than the reference price are to be included in the imbalance.

⁶ On a day that trading on the Exchange is scheduled to close earlier than 4:00 p.m., the Exchange will disseminate Order Imbalance Information every five (5) seconds starting at 10 minutes prior to the Close. See Exchange Rule 123C(6)(a)(v).

⁷ For more information on the execution of orders at the Close, see Exchange Rule 123C(7). Members and member organizations are reminded that, when arranging the Close, they may not use the Display Book system in an inappropriate manner designed to discover information about unelected stop orders.

DMM's use of this offsetting interest to minimize significant price dislocation on the Close will result in a closing-price coupled order between the DMM and member, member organization or customer. If the member, member organization or customer agrees, the DMM may include this interest in offsetting an imbalance when setting the closing price and increase DMM participation in the closing print to the extent of the new contra interest. After the Close, the DMM will liquidate or cover the related dealer position, and the member, member organization or customer will acquire the position. Such closing-price coupled orders are executed at the Ramp.

It is important to note that Rule 902 may not be relied on for the entry of an order after the Close when there is no MOC/LOC imbalance or when the imbalance would not result in significant volatility and/or price dislocation. In addition, it cannot be used if the Close has already been printed.

d. Extreme Order Imbalances at or Near the Close

In order to avoid significant dislocation in the closing price that may result from an order entered or represented at or near the Close, Exchange Rule 123C(9) permits the Exchange, on a security-by-security basis, to temporarily suspend the hours of operation under Rule 52 so that offsetting interest may be solicited from both on-Floor and off-Floor participants and entered to reduce the size of the imbalance. Extensions of trading under Rule 123C(9) may be designated by the Exchange for a specific time period up to 30 minutes after the scheduled close. Off-setting interest is solicited using Exchange Trader Updates as well as messages sent directly to Floor broker hand-held devices. These Exchange issued solicitation requests include information regarding security symbol, the imbalance amount and side, the last sale price, and a designated order acceptance cutoff time (generally five minutes from the issuance of the solicitation request). Offsetting interest submitted in response to an Exchange-issued solicitation request must be a limit order priced no worse than the last sale, irrevocable and entered no later than the order acceptance cut-off time indicated in the solicitation request. Exchange systems will accept interest entered electronically in the named security, after 4:00 p.m. only if Rule 123C(9)(a)(1) is invoked.

Exchange systems will **not** verify side or price, and will not block post-4:00 p.m. cancellation of interest submitted under this rule. Therefore, member and member organizations entering such interest are responsible for ensuring compliance with the rule, such that the only interest that may be entered in response to such a solicitation request is: (i) offsetting; (ii) a limit order priced no worse than the last sale price; and (iii) not cancelled.

Failure to comply with these requirements for entering electronic interest in response to a solicitation request is a violation of Exchange rules and may result in disciplinary action. [See](#) Information Memoranda 09-20 (May 5, 2009) and 10-52 (December 22, 2010).

Rule 123C(9) also permits temporary suspension of the prohibition on the cancellation or reduction of a MOC/LOC order after 3:58 p.m. where there is a legitimate error in such an order *and* the execution of the order would cause *significant* price dislocation at the Close.

Only the DMM assigned to a particular affected security may request relief under Rule 123C(9). A request for relief under Rule 123C(9) must be approved and supervised by an Executive Floor Governor or qualified NYSE Euronext employee and supervised by a qualified Exchange officer, as defined in Rule 48(d). All Rule 123C(9) related approvals must be recorded in FORTE.

IV. Contingencies in the Event of a System Interruption

a. Contingency Scenarios

NYSE Operations has notified all members and member organizations as to how to proceed in the event of a systems outage on June 22, 2012. There are four contingency scenarios, each of which is described below for convenience. Members and member organizations should refer to the NYSE Operations memorandum published June 11, 2012, for further details. The memo is available on www.nyx.com at https://markets.nyx.com/sites/markets.nyx.com/files/traderupdate-attachments/russell_contingencies_2012.pdf. In addition, members and member organizations are advised that in Contingency Scenarios 2 and 3, the procedures of Exchange Rule 123C will operate pursuant to the trading halt provisions.

1. Contingency Scenario 1

In the event of a system interruption that occurs intraday whereby normal trading is resumed prior to 3:45 p.m. the Exchanges will begin the normal Market on Close posting process (3:45 pm, with some Informational Imbalance publications as early as 3:00 p.m.). There will be the normal 4:00 p.m. close time.

2. Contingency Scenario 2

In the event of a system interruption that occurs intraday and normal trading is resumed between 3:45 and 3:59 p.m., the Exchanges will bypass the normal 3:45 p.m. MOC publication and utilize a single MOC publication before the 4:00 p.m. close time, if practicable. Although the Closing process may extend later than the usual 4:00 p.m. close time, order delivery will stop at 4:00 p.m. Any orders in Exchange systems will be executed in one Closing trade as soon as possible thereafter.

3. Contingency Scenario 3

In the event of a system interruption that occurs intraday and service is restored after the 4:00 p.m. close time, the Exchange may not publish the 3:45 pm Mandatory MOC/LOC Imbalance Publication. The Exchange will notify market participants of the new close time and will price the close at or around this time. The new time will be communicated to market participants via the market wide call and a system status posting.

4. Contingency Scenario 4

In the event of a system interruption that occurs intraday and service is not restored, the NYSE and NYSE MKT closing prices on June 2 will be the last regular way trade on the NYSE and NYSE MKT, respectively.

b. Contingency Preparedness

Members are reminded that they should have Floor stationery supplies on hand in the event they are unable to enter or cancel orders through the system. Should a system interruption affect electronic time-stamping functionality, members and member organizations may manually record required time information. If the Broker Booth Support System (BBSS) is functioning, but the broker handheld is not, Floor brokers must carry the BBSS time onto their paper orders. Under all other circumstances, the time of order entry must be recorded by hand in the Booth, by the Floor broker or clerk.

V. Adequacy of Operations and Supervisory Staff

All members and member organizations, including DMMs, should ensure that both operational and supervisory staffing on and around June 22, 2012 will be sufficient to monitor and process all orders, regardless of the form in which they are received, as well as to handle the increased workload anticipated as a result of the Russell Reconstitution. All members and member organizations should

also review their systems to ensure that they have adequate capacity to handle the expected increase in volume. For example, DMM firms should review their DMM Unit algorithm to ensure that they meet their obligations to maintain a fair and orderly market. DMMs are reminded to seek the advice of a Floor Official regarding any unusual situations as quickly as possible.

VI. Supervision

a. Review of Policies and Procedures

Members and member organizations should carefully review their procedures as well as their supervisory systems for handling orders in connection with the Russell Reconstitution on June 22, 2012. Members and member organizations are expected to review their practices for handling orders at or near the Close, particularly with respect to any orders where there is an on-close or other price guarantee for those securities that are part of the rebalancing. Reviews should include both orders that are handled manually as well as those orders that are handled systemically, such as orders that are handled by a computer algorithm. In addition, members and member organizations should take all necessary steps to ensure that the relevant trading, compliance and back-office staff are familiar with firm procedures for handling orders at or near the Close. Members and member organizations should also be mindful of the guidance issued in Information Memo 09-22 (May 28, 2009), available at http://www.nyse.com/nyse/nyse/nyse/information-memos/pdf?memo_id=09-22, regarding procedures for escalating and addressing inquiries arising from real-time regulatory or trading issues.

In addition, members and member organizations are reminded of their obligation to have adequate systems and controls relating to the use of firm systems by correspondents or others. Please consult NYSE Information Memos 11-13 (May 16, 2011), available at http://www.nyse.com/nyse/nyse/nyse/information-memos/pdf?memo_id=11-13, for more information.

b. Adequacy of Compliance Program

Members and member organizations are also reminded to ensure that they have in place a robust compliance program that includes adequate supervisory policies and procedures to monitor for compliance with Exchange Rule 123C and the guidance contained in this Information Memo. Firm policies and procedures must be adequate to ensure that all procedures related to MOC/LOC orders and orders entered at or near the Close are appropriately followed, and to detect and deter any actions that may violate Exchange or SEC rules.

c. Due Diligence Requirements

Consistent with the requirements of Exchange Rule 405, before any order with instructions to participate at the close is transmitted to the Floor the member or member organization accepting the order must exercise due diligence to learn the essential facts relative to the order, including the purpose and propriety of the at-the-close instruction. In addition, an imbalance of orders at or near the Close, caused in part by the entry of such orders, could lead to trading being halted in the security and such orders not receiving an execution.

d. Supervision to Prevent Improperly Affecting the Close

Members and member organizations must also ensure that their activity does not artificially impact the closing price. As such, members, member organizations and compliance staff should be mindful of Information Memo 05-52 (August 1, 2005), available at http://www.nyse.com/nyse/nyse/nyse/information-memos/pdf?memo_id=05-52, regarding Volume

Weighted Average Price (VWAP) trading at or near the Close, which addresses the responsibility for ensuring that trading strategies engaged in to facilitate or hedge VWAP orders have an economic basis and do not have the effect of marking the close or marking the value of a position. Member organizations should also be aware that certain orders and order entry practices may have the potential to cause price dislocation before the Close or distort the closing price due to prevailing market conditions at the time the order is entered. Similarly, trading at or near the Close is of particular concern due to the condensed time frame for execution, where the resultant closing price is used to set benchmarks, such as index rebalancing. As a result, manipulation concerns may be heightened when trading occurs at or near the close.

Firms should review procedures utilized in connection with orders to be executed at or near the Close with their traders and other order-entry personnel. Firms should also review systemic order-entry functions (e.g., algorithms or “smart servers”) for compliance with the provisions of this Information Memorandum. Firms should also review the provisions of Information Memo 95-28 (July 10, 1995), available at http://www.nyse.com/nysenotices/nyse/information-memos/pdf?memo_id=95-28, which discusses trading near the Close and activity that would constitute violations of Exchange Rules as well as federal securities laws. In that connection, members and member organizations are reminded that, where a firm has committed to purchase from (sell to) a customer an order at a price that is derived from the closing price (e.g., VWAP and MOC orders) while also reserving a significant portion of its hedging or covering transaction to be executed at or near the Close, they must operate with substantial care. If the transaction is completed in a manner that does not effectively place the firm at market risk or if the transaction does not provide an opportunity for possible contra side interest to develop and/or react to the activity, it would raise manipulative concerns and would operate as conduct inconsistent with just and equitable principles of trade. Members and member organizations should consult Information Memo 05-52 for further guidance.

e. Compliance with Federal Securities Laws and Rules

In addition to complying with Exchange Rules and policies, members and member organizations should review other applicable federal securities laws and regulations, including Section 9(a)(2) of the Securities Exchange Act, Regulation SHO and Rule 10b-5, as well as the margin and capital rules. Firms must ensure that they have adequate policies and procedures to detect, deter and prevent such potentially violative conduct.

VII. Staff Contacts

Operational questions regarding this Information Memo should be directed to:

- Robert Airo, Senior Vice President, NYSE Operations, at 212.656.5663, or
- Paul Bauccio, Senior Vice President, NYSE Operations, at 212.656.2929, or
- Michael Rutigliano, Vice President NYSE Operations, at 212.656.4679, or
- Dennis Pallotta, Director, NYSE Operations, at 212.656.5236, or
- Sonia Rosa, Managing Director, NYSE Operations, at 212.656.2899.

Questions concern interpretations of Exchange Rules in connection with this Information Memo should be directed to:

- Clare Saperstein, Vice President, NYSE Regulation, Inc., 212.656.2355, or
- David De Gregorio, Chief Counsel, NYSE Regulation, Inc., 212.656.4166.
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Regulatory questions relating to this Information Memo should be directed to:

- Patricia Bergholc, Director, FINRA On Floor Surveillance Unit, 917.281.3054, or
- Thomas C. Bruno, Director, FINRA Market Regulation, 917.281.3081, or
- John C. Saxton, Jr., Director, FINRA Market Regulation, 917.281.3114, or
- Michael Fryer, Associate Director, FINRA Market Regulation, 917.281.3071.

Questions may also be directed to the FINRA On-Floor Surveillance Unit via the White Phone or in person at their Booth on the Floor.

Should a member or member organization experience any systems issues, please immediately contact NYSE Dot Services at 866.DOT.DESK (362.3375). For Regulatory matters emanating from systems issues, please immediately contact FINRA On-Floor Surveillance Unit at 212.656.5398.