In January, the SEC approved the Twelfth Amendment to the Limit Up-Limit Down plan, as well as a handful of separate rule filings that will further harmonize how the exchanges handle a LULD trading pause (for a refresher on how LULD works, see our Primer and Cheat Sheet). The centerpiece of these changes is a new framework for the exchanges’ reopening auction collars.

Currently, NYSE Arca and Bats BZX employ static collars to ensure that their listings don’t reopen at prices far from last sale (Nasdaq, NYSE and NYSE MKT don’t employ such collars). On August 24th, 2015, when the demand for liquidity was elevated and net asset values were hard to ascertain, Arca’s collars proved to be too tight. Arca reopened many exchange-traded products inside the collars without pairing off all of its market orders, and released the unpaired orders into the continuous trading session. In many cases, these orders ripped through thinly populated order books and quickly triggered new LULD trading pauses.

To better accommodate an influx of one-sided market orders in stressed markets, NYSE Arca, Bats BZX and Nasdaq will implement a dynamic collar framework sometime in the third quarter. Every five minutes, the collars will widen out by five percent (or by $0.15 for stocks priced below $3) in the direction of an order imbalance until that imbalance can be paired off inside the collars. In the example shown in the diagram below, the lower collar needs to be widened out three times before a sell-order imbalance can be paired off.
There are a few wrinkles in the new framework worth noting:

- During the first and second five-minute pauses, the primary exchange can accept new orders and modifications, but it cannot conduct the reopening auction until the end of the pause (assuming it can do so at a price inside the collars). Additional pauses are “live” in the sense that the primary exchange can execute the reopening auction as soon as it has enough trading interest to pair off the imbalance – but again, it can only do so at a price inside the collars.

- Non-primary exchanges and off-exchange trading centers are prohibited from resuming quoting and trading stocks/ETPs that the primary can’t reopen due to an imbalance. However, if the primary notifies the Securities Information Processor that it can’t reopen the stock/ETP because of a systems or technology issue, the SIP will declare that trading will resume without the primary at a designated time. At that designated time, the SIP will disseminate new LULD bands, with the LULD band that triggered the pause serving as the new Reference Price.

- Per the recently proposed Thirteenth Amendment to the plan, the primary exchange and the SIP will both include the prices of the collars in their data feeds – something that they don’t do today.

- The New York Stock Exchange and NYSE MKT don’t currently have reopening collars, and haven’t yet proposed to implement the new, dynamic framework – although we understand that they may be doing so soon. The involvement of human market makers in their auction processes likely means that their collars would work slightly differently than those of the fully automated exchanges.

**Additional Twelfth Amendment Rule Changes**

The dynamic collars are the centerpiece of the Twelfth Amendment, but these three minor changes are also worth highlighting:

1. If the primary exchange reopen a stock/ETP on a quote, and the bid is a zero bid or the offer is a zero offer (or both are zeroes), the Reference Price for the new LULD bands will be equal to the band that triggered the pause. As things stand today, a reopen on a zero bid or zero offer results in no LULD bands being disseminated.

2. If a stock/ETP is in a paused state at 3:50 p.m. or later, the primary exchange will not seek to reopen it. Instead, it will attempt to execute a closing auction trade. Currently, the primary exchange only abandons the LULD reopening process in favor of its closing process if the pause is declared at 3:50 p.m. or later.

   - **EXAMPLE:** Today, a stock/ETP that is paused at 3:47 p.m. would be reopened at or after 3:52 p.m. Under the new rules, because the stock/ETP is in a paused state as of 3:50 p.m., the primary exchange will keep it paused until 4 p.m., at which time it will attempt to execute a closing auction trade.

3. Exchanges cannot deem any reopening transaction to be Clearly Erroneous.

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**What is the Reference Price?**

The Reference Price is the price the SIP uses to construct the LULD price bands for a stock or ETP. The SIP adds/subtracts a percentage amount to/from the Reference Price to calculate the price of the upper/lower band.