November 13, 2012

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

RE: File No. SR-BYX-2012-019

Dear Ms. Murphy:

BATS Y-Exchange, Inc. (the "Exchange" or "BYX") is responding to comments submitted by the Securities Industry and Financial Markets Association ("SIFMA") regarding the above-referenced rule filing to adopt a Retail Price Improvement ("RPI") Program (the "RPI Program" or "Program").[1] As proposed, the RPI Program would operate as a one-year pilot program to provide price improvement opportunities to members sending retail orders. The price improvement opportunities would be made available through non-displayed retail price improvement orders that any member can enter on the Exchange. Non-displayed retail price improvement orders must be priced better than the NBBO by at least $0.001, and the existence of such orders would be disseminated on the consolidated tape through a retail liquidity identifier that contains symbol and side, but not price or size.

In its comment letter, SIFMA notes that "the Exchange's RPI Program would raise substantially identical policy considerations as the retail liquidity program of the New York Stock Exchange . . . and NYSE Amex LLC, now known as 'NYSE MKT'".[2] And, while the Commission resolved those policy concerns in favor of approval of the retail liquidity programs proposed by NYSE and NYSE MKT, SIFMA has submitted this comment letter, "reiterating its previous concerns to keep them on the public record as the Commission considers the BYX proposal."[3] While there are important differences between BYX's proposed RPI Program and the NYSE and NYSE MKT liquidity provider programs, SIFMA's comments are not directed towards those differences. BYX addresses SIFMA's concerns in turn below.

1 See Letter to the Commission from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA, dated September 26, 2012 ("SIFMA Letter").

2 SIFMA Letter at p. 2.

3 Id.

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1. Two-tiered market structure

SIFMA is concerned that the Exchange's proposal creates a two-tiered market structure that raises fair access issues. The basis for this concern is that, as proposed, BYX members would have the ability to submit retail price improvement orders in increments as small as $0.001 that are only available to other members sending Retail Orders as defined in the proposed BYX rules. Members sending orders that do not meet the definition of Retail Orders are not entitled to execute against a retail price improvement order, which SIFMA contends is inconsistent with Section 6(b)(5) of the Exchange Act, which prevents unfair discrimination between market participants.

While the Exchange believes that markets and price discovery optimally function through the interactions of diverse flow types, it also believes that growth in internalization has required differentiation of retail order flow from other order flow types. The differentiation proposed by the Exchange in connection with the RPI Program is not designed to permit unfair discrimination, but instead to promote a competitive process around retail executions such that retail investors would receive better prices than they currently do through bilateral internalization arrangements. Thus, the Exchange believes that its RPI Program is consistent with Section 6(b)(5) of the Act because, like NYSE and NYSE MKT's retail liquidity programs, the Exchange's RPI Program is reasonably designed to attract retail order flow to the exchange environment, while helping to ensure that retail investors benefit from the better price that liquidity providers are willing to give their orders. And, like NYSE and NYSE MKT's retail liquidity programs, the Exchange's RPI orders will be designated on the consolidated tape, and while institutional investors could not submit retail orders, they could submit retail price improvement orders that would have the opportunity to interact with retail orders.

The Commission addressed this issue previously in connection with the approval of the NYSE's and NYSE MKT's retail liquidity program, finding that:

> [W]hile the Program would treat retail order flow differently from order flow submitted by other market participants, such segmentation would not be inconsistent with Section 6(b)(5) of the Act, which requires that the rules of an exchange are not designed to permit unfair discrimination. The Commission has previously recognized that the markets generally distinguish between individual retail investors, whose orders are considered desirable by liquidity providers because such retail investors are presumed on average to be less informed about short-term price movements, and professional traders, whose orders are presumed on average to be more informed. The Commission has further recognized that, because of this distinction, liquidity providers are generally more inclined to offer price improvement to less informed retail orders than to more informed professional orders. Absent opportunities for price improvement, retail investors may encounter wider spreads that are a consequence of liquidity providers interacting with informed order flow. By creating additional competition for retail order flow, the Program is reasonably designed to attract retail order flow to

> the exchange environment, while helping to ensure that retail investors benefit from the better price that liquidity providers are willing to give their orders.[4]

The Commission further noted that retail price improvement orders would be designated on the consolidated tape through a retail liquidity identifier that is visible to all market participants and that, although institutional investors could not submit retail orders, they could submit retail price improvement orders that would have the opportunity to interact with retail orders.[5]

2. Sub-Penny Quoting

SIFMA argues that an RPI order entered on BYX in a sub-penny increment would violate the prohibition under Rule 612 of Regulation of NMS on exchanges accepting or ranking an order in an increment smaller than the minimum pricing increment.[6] SIFMA acknowledges that the Commission granted an exemption from Rule 612 for the NYSE and NYSE MKT retail liquidity provider programs and that BYX has requested similar relief in connection with its RPI Program, but contends that such relief should only be granted pursuant to formal Commission rule-making rather than through individual exchange exemptions.

Rule 612 establishes a minimum pricing increment for NMS stocks providing in pertinent part that national securities exchanges, ATSs, vendors, brokers and dealers shall not display, rank, or accept from any person a bid or offer, an order, or an indication of interest in any NMS stock priced in an increment smaller than $0.01 if that bid or offer, order, or indication of interest is priced equal to or greater than $1.00 per share.[7] The Rule similarly establishes a minimum increment of $0.0001 for orders priced less than $1.00 per share.[8] The Rule further provides that the Commission may, by order, exempt:

> any person, security, quotation, or order, or any class or classes of orders 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.[9]

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4 Order Granting Approval to Proposed Rule Changes, as Modified by Amendments Nos. 1 and 2, Adopting NYSE Rule 107C to Establish a Retail Liquidity Program for NYSE-Listed Securities on a Pilot Basis Until 12 Months From Implementation Date, and Adopting NYSE Amex Rule 107C to Establish a Retail Liquidity Program for NYSE Amex Equities Traded Securities on a Pilot Basis Until 12 Months From Implementation Date, and Granting Exemptions Pursuant to Rule 612(c) of Regulation NMS Exchange Act Release No. 67347 (July 3, 2012) ("NYSE and NYSE MKT Retail Liquidity Provider Approval Order"), at pp. 25-26.

5 Id. at pp. 26-27.

6 SIFMA Letter at p. 3.

7 Rule 612(a) of Regulation NMS.

8 Rule 612(b) of Regulation NMS.

9 Rule 612(c) of Regulation NMS.

At the core of the Rule's purpose was the Commission's concern with the potential of sub-penny increments to erode the incentives of investors to display limit orders. The Commission proposed the Rule in an effort to "limit the ability of a market participant to gain execution priority over a competing limit order by stepping ahead by an economically insignificant amount."[10] Among the related concerns associated with sub-penny quoting referenced by the Commission in adopting the Rule 612 were: (1) the possible decrease in market liquidity attributable to a reduced use of limit orders by investors; (2) the erosion of customer protections such as exchange priority rules and Manning where market participants could gain execution priority over a limit order for an "infinitesimally small" increment; (3) flickering quotations resulting from widespread sub-penny pricing and attendant best execution concerns; (4) a potential decrease in market depth at the inside; and (5) potentially increased incentives on the part of institutions, given reduced depth at the inside, to rely on execution alternatives "away from the exchanges and Nasdaq" and the increased fragmentation that such incentives could drive.[11]

With respect to concerns about displayed limit orders losing priority to an insignificantly better priced order and, hence, causing eroding the incentives to display limit orders, the Exchange does not believe an exemption from the Rule's requirements will reduce such incentives. Market participants that display limit orders currently are not able to interact with marketable retail order flow because it is almost entirely routed to internalizing OTC market makers that offer subpenny executions. Consequently, enabling the Exchange to compete for this retail order flow through the Program should not materially detract from the current incentives to display limit orders, while potentially resulting in greater order interaction and price improvement for marketable retail orders.

With respect to other concerns sought to be addressed by the Rule 612 – loss of liquidity at the inside, best execution, capacity, and fragmentation – each relate to sub-penny quoting and not sub-penny trading. The Commission drew the distinction plainly in the Adopting Release and went on to flag the particular benefit of sub-penny executions to retail investors:

> The Commission believes at this time that trading in sub-penny increments does not raise the same concerns as sub-penny quoting. Sub-penny executions do not cause quote flickering and do not decrease depth at the inside quotation. Nor do they require the same systems capacity as would sub-penny quoting. In addition, sub-penny executions due to price improvement are generally beneficial to retail investors.[12]

Pursuant to the RPI Program, neither Retail Orders nor RPI Orders will be displayed by the Exchange. Accordingly, the nature of the proposed order types simply does not give rise to

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10 Securities Exchange Act Release No. 34-51808, 70 Fed. Reg. 37496, 37551 (June 29, 2005) ("NMS Adopting Release").

11 NMS Adopting Release at 37551-52.

12 NMS Adopting Release at 37556.

the concerns addressed by the Rule 612. There would be no potential for them to jeopardize the incentives to place limit orders, or to otherwise implicate the customer protection, capacity, best execution, liquidity and fragmentation concerns addressed by Rule 612. In addition, the Program would actually serve to encourage the additional display of liquidity in the marketplace and would not detract from the quality of orders in the marketplace as raised in Regulation NMS.

Similarly, while the Exchange would "accept" and "rank" non-displayed RPI Orders using increments less than the minimum pricing increment as described above, doing so would in no way undermine the purpose or framework of the Rule 612. Indeed, the prohibition on the acceptance and ranking based on sub-pennies was directed at the practice of private sub- penny display that had developed on ECNs in the wake of decimalization.[13] Some ECNs during that period were accepting, ranking and privately displaying sub-penny orders to subscribers while at the same time (then pre-exchange) Nasdaq and the exchanges were requiring their members to quote in pennies and the public quote stream reflected those quotes only in pennies. The Commission expressed concern that this lack of uniformity was "creating hidden markets whereby sophisticated traders [could] view and access better prices than those available to the general public."[14] The Sub-Penny Rule's prohibition on accepting and ranking sub-penny orders is therefore best understood as an effort to address and prevent the development of private or hidden markets with better-priced sub-penny orders. Because the RPI Orders would remain at all times entirely non-displayed, they present no risk that a hidden sub-penny market would develop. Rather, the whole point of the RPI Program is to make better prices available to the general public by fostering competition on public markets for retail orders

For the reasons described above, as well as others articulated in its full request for exemptive relief, the Exchange believes that the granting of exemptive relief in connection with approval of the Program is appropriate. The Exchange also notes that the RPI Program is functionally identical to the NYSE and NYSE MKT retail liquidity provider programs in this regard and BYX should be entitled to the same exemptive relief accorded NYSE and NYSE MKT. Moreover, like the NYSE and NYSE MKT retail liquidity provider programs, BYX's RPI program has been proposed as a one-year pilot program. BYX anticipates that during this year, the industry will gain valuable experience with, and BYX will collect data on the impact of, sub-penny orders that will be useful in enabling the Commission to further analyze this issue.

3. Quote Dissemination

Like the NYSE and NYSE MKT retail liquidity provider programs, under BYX's proposed RPI Program, when an RPI Order is entered on the Exchange, the Exchange will disseminate a retail liquidity identifier that includes symbol and side, but not price or size. SIFMA is concerned that the retail liquidity identifier is a "quote" and, as such, is subject to Rule

[13] Securities Exchange Act Release No. 34-49325, 69 Fed. Reg. 11126, 11163-64 (Mar. 9, 2004) ("NMS Proposing Release"). The Commission noted the "growing trend in the industry, particularly among ECNs, to display quotations in their proprietary systems in sub-pennies . . . ." Proposing Release at 11163.

[14] NMS Proposal at 11171.

602 of Regulation NMS, which requires exchanges to, among other things, collect, process, and make available to vendors the best bid, best offer, and quotation sizes communicated by members of the Exchange, and subject to Rule 611 of Regulation NMS, the Order Protection Rule, which requires trading centers to maintain policies and procedures reasonably designed to prevent trade throughs of protected quotations. SIFMA argues that the Commission should "conduct an analysis of whether a [retail liquidity identifier] is a quote and include that analysis in its consideration of the RPI Program." SIFMA is similarly concerned that a lack of clarity from the Commission as to whether a retail liquidity identifier is a quote creates uncertainty regarding the application of Rule 610 of Regulation NMS related to access to quotations. And, finally, SIFMA is further concerned about the impact of retail liquidity identifiers on a broker-dealer's best execution obligations, and the extent to which broker-dealers would be required to consider retail liquidity identifiers in making order routing decisions.

With respect to compliance with Rule 602 of Regulation NMS, BYX, like NYSE and NYSE MKT, is requesting that the Commission grant it no-action relief from that rule. The basis for this request is the Exchange's belief that neither retail price improvement orders considered on their own, or together with retail liquidity identifiers, meet the definition of a "bid" or "offer" in Rule 600(b)(8) of Regulation NMS because they do not communicate a specific price. As such, the Exchange does not believe they should be subject to the requirements of Rule 602. Further, because the Exchange believes retail price improvement orders are not quotations as defined in Rule 602, they are also not subject to Rule 611. BYX believes each of these issues was considered by the Commission in connection with its approval of the NYSE and NYSE MKT's retail liquidity programs. In fact, the Commission granted no-action relief to NYSE and NYSE MKT based on identical facts,[15] and BYX believes its RPI Program is entitled to the same no-action relief.

Similarly, with respect to SIFMA's concerns about the application of Rule 610 of Regulation NMS, BYX notes that the Commission considered this question in the context of approving the NYSE and NYSE MKT retail liquidity programs and decided that "[b]ecause the Commission has determined that the Program is not unfairly discriminatory pursuant to Rule 610, it need not determine whether the Retail Liquidity Identifier is a "quote" for purposes of Rule 610." As previously stated, BYX's RPI Program is identical in this regard and as such, the Commission need not determine whether the RPI Program's retail liquidity identifier is a quote under Rule 610.

With respect to a broker-dealer's best execution obligations, BYX does not believe that its RPI Program creates any best execution challenges that are not already present in today's markets, and BYX believes that a broker-dealer would consider the RPI Program when conducting its best execution analysis.

[15] Letter to Janet McGinness, EVP & Corporate Secretary, General Counsel, NYSE Markets from David Shillman, Associate Director, Division of Trading and Markets, SEC, dated July 3, 2012, granting NYSE and NYSE MKT no-action relief from Rule 602 of Regulation NMS in connection with proposals to establish a retail liquidity provider program.

BYX notes that the Commission also considered this issue in the context of approving NYSE and NYSE MKT's retail liquidity provider program. The Commission stated the following:

> [T]he Commission does not believe that the [retail liquidity provider program] will create any best execution challenges that are not already present in today's markets. A broker's best execution obligations are determined by a number of facts and circumstances, including (1) the character of the market for the security (e.g., price, volatility, relative liquidity, and pressure on available communications); (2) the size and type of transaction; (3) the number of markets checked; (4) accessibility of the quotation; and (5) the terms and conditions of the order which result in the transaction. See FINRA Rule 5310; see also Disclosure of Order Execution and Routing Practices Adopting Release, supra note 633. A broker would consider the [retail liquidity provider program] when conducting this analysis.[16]

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BYX appreciates the opportunity to respond to SIFMA's comment letter regarding BYX's proposed RPI Program. Please feel free to contact me if you have any questions in connection with matter.

Sincerely,

Eric Swanson
SVP, General Counsel and Secretary
BATS Global Markets, Inc.

[16] NYSE and NYSE MKT Retail Liquidity Provider Approval Order at FN 75.

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