May 24, 2013

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

RE: SR-BYX-2013-008

Ms. Murphy:

BATS Y-Exchange, Inc. ("BYX" or the "Exchange") is responding to the comment letter dated March 11, 2013, submitted by the Securities Industry and Financial Markets Association ("SIFMA") on the above-referenced proposed rule change filed by the Exchange (the "SIFMA Comment Letter").[1] The Exchange is in substantial agreement with the recent comment response letters submitted by NYSE Euronext on behalf of NYSE and NYSE MKT[2] and NASDAQ OMX LLC on behalf of Nasdaq.[3] As a result, the Exchange's comment response letter in large part reiterates these comment responses.

The proposed changes to BYX Rule 11.24, which governs the Exchange's Retail Price Improvement Program (the "Program"), would amend the attestation requirement of these rules to allow a Retail Member Organization ("RMO") to attest that "substantially all" orders submitted to the Program will qualify as "Retail Orders." The rules currently require RMOS to attest that "any order" will so qualify, effectively preventing certain significant retail brokers from participating in the Program due to operational constraints.

For the reasons set forth in this letter, the Exchange does not believe that the arguments advanced in the SIFMA Comment Letter provide a basis for the Commission to disapprove the proposed amendment to the Program.

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[1]   Letter to the Commission from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA, dated March 11, 2013 ("SIFMA Comment Letter"). The SIFMA comment letter also addressed similar rule change proposals submitted by New York Stock Exchange LLC ("NYSE"), NYSE MKT, LLC ("NYSE MKT"), and the Nasdaq Stock Market LLC ("Nasdaq") to their respective versions of the Program.

[2]   *See* Letter to the Commission from Janet McGinness, Senior Vice President-Legal & Corporate Secretary, Legal & Government Affairs, NYSE Euronext, dated April 2, 2013.

[3]   *See* Letter to the Commission from Jonathan F. Cayne, Associate General Counsel, NASDAQ OMX LLC, dated April 24, 2013.

I.   **The Proposed Amendment is Intended to Remove a Significant Unintended Obstacle to Greater Participation by Retail Orders in the Program**

As explained in the rule proposal, several significant retail brokers, who are also SIFMA members, have informed the Exchange that limitations in order management systems and routing networks used by these firms may make it infeasible for them to be certain that 100% of the agency orders that they would direct to the Program qualify as "Retail Orders." Because of the categorical nature of the current attestation requirement and the burdens associated with the systems changes required to be able to satisfy this requirement, these firms have informed the Exchange that they have been unwilling to participate in the Program. The unwillingness of these firms to participate in the Program deprives all of their retail customers of the opportunity to benefit from the Program. These firms have also informed the Exchange that they believe the systems they use are sufficiently robust to enable them to attest, with a reasonable degree of confidence that substantially all of the orders they would direct to the Program would qualify as "Retail Orders." Therefore, adoption of a "substantially all" attestation requirement should enable significantly broader participation in an Exchange-sponsored program where retail investors' orders are exposed for price improvement in a more competitive environment with greater transparency vis-à-vis broker-sponsored internalization venues.

In its comment letter, SIFMA states that the inability of some retail brokers to satisfy the current attestation requirement "is undermined by examples of situations in which broker dealers must strictly comply with definitions of 'customers.'"[4] Although the Exchange does not have direct insight into the technology capabilities of a firm, as noted above, several retail brokers have indicated to the Exchange that their respective order flow is routed in aggregate for retail execution purposes and a de minimis amount of that order flow may have been generated electronically. Consequently, regardless of whether or not the order may have been initiated by a natural person, these firms are unable to attest that 100% of orders meet the strict definition of Retail Order without developing, testing and deploying new technology.

Furthermore, SIFMA's reference to the definition of "customer" obscures rather than clarifies the question at issue here, which is the distinction between orders that originate with natural persons and those that do not. The point of limiting the Program to natural persons (and excluding orders generated by trading algorithms) is to allow retail customers to benefit from the value that liquidity providers put on interacting with order flow that may be less informed with respect to short-term price movements. The distinction between public and professional customers in the options markets, in contrast, operates entirely differently. It is a volume-based threshold roughly designed to identify market participants with technological and informational sophistication. A Retail Order, however, is a much higher hurdle to meet with regard to segmenting order flow than identifying between public and professional customers in the options industry.

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[4]   SIFMA Comment Letter at 5.

II.   The Proposed Changes do not Represent a Significant Change in the Scope of the Program

SIFMA asserts that the Exchange's proposal would broaden the definition of "Retail Orders" to a degree "well beyond the scope that justified the original approval of the Program...."[5] This is simply not the case. As stated in the rule proposals, if the amendment is approved, the Exchange intends to issue Trader Notices that will make clear that the "substantially all" language is meant to permit isolated and de minimis quantities of agency orders that do not qualify as Retail Orders but that cannot be segregated from Retail Orders due to systems limitations. Moreover, the Exchange notes that the "substantially all" language will not allow a significant number of orders that do not qualify as "Retail Orders" to participate in the Program. The proposed amendment is designed to accommodate system limitations at RMOs to segregate Retail Orders from de minimis quantities of other agency orders. An RMO's compliance with this requirement will be monitored as RMOs will need to retain, in their books and records, adequate substantiation that this requirement has been satisfied and the Chicago Board Options Exchange, Incorporated will, on behalf of the Exchange, review a member organization's compliance with these requirements.

The Exchange also does not understand SIFMA's contention that moving to a "substantially all" standard will make it more difficult for the Exchange to effectively monitor compliance with the Program's Retail Order requirements.[6] It is simply counter-intuitive to suggest that a "substantially all" standard, which by its nature allows for a de minimis number of exceptions, is more difficult to monitor or enforce than an absolute standard, which permits no exceptions.

III.   Competitive Forces will Act as an Additional Check on Non-Retail Participation in the Program

The Commission has on several occasions noted that retail orders are generally considered to be more desirable by liquidity providers than those submitted by professional traders, whose orders are presumed on average to be more informed about short-term price movements.[7] To the extent that, notwithstanding the requirements and restrictions described above, a significant number of non-Retail Orders were able to be entered into the Program, liquidity providers would become less willing to participate, thereby undermining the effectiveness of the Program in attracting a larger share of Retail Order flow.[8] Therefore, the

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[5]   SIFMA Comment Letter at 4.

[6]   *See* SIFMA Comment Letter at 6.

[7]   *See* Exchange Act Release No. 67347 (July 3, 2012), 77 FR 40673 (July 10, 2012); see also Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3594, 3606 n. 67 (January 21, 2010) ("Concept Release on Equity Market Structure").

[8]   In particular, the Exchange understands that liquidity providers utilize the average realized spread measurement to gauge the information content of orders they execute under the Program. In basic terms, average realized spread compares prices paid by a liquidity provider to the mid-point of the NBBO five

Exchange, which operates in a highly competitive environment, will have powerful incentives to minimize the ability of non-Retail orders to participate in the Program in order to maximize the likelihood that the Program can achieve their stated objectives of attracting additional retail order flow to the Exchange.

Further, the Program is designed to attract retail order flow to the Exchange by replicating and enhancing the current practices of broker-dealers that internalize much of the market's retail order flow. As previously mentioned, the execution of retail orders today occurs in a largely segmented environment. Broker-dealers do not compete for these orders by offering aggressive prices, but rather through bilateral internalization arrangements. The Program offers a competitive alternative to segmentation and internalization, and the "substantially all" standard, together with the policies and procedures of the Program, offer an exchange-sponsored and more transparent alternative than what is available in broker-sponsored internalization venues. It is worth noting that this very discussion of the details of the Program is itself a direct reflection of the heightened obligation of exchanges to be commercially and operationally transparent with their members. No such debate would be occurring if an ATS or broker-dealer/internalizer was implementing a similar change.

IV.   Conclusion

For the reasons set forth above, the Exchange does not believe that the SIFMA Comment Letter has identified any concerns that would support disapproving the proposed amendment. The Exchange therefore respectfully requests that the Commission approve the proposed amendment.

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minutes after the execution. In doing so, it serves as an indicator of the information content of the order with respect to short-term price movements. See Exchange Act Release No. 43590 (November 17, 2000), 65 FR 75414, 75423-24 (December 1, 2000) ("The term 'average realized spread' . . . is calculated by comparing the execution price of an order with the midpoint of the consolidated BBO as it stands five minutes after the time of order execution . . . . [A]verage realized spread can measure the extent to which 'informed' and 'uninformed' orders are routed to different market centers . . . ."). To the extent that more than isolated and de minimis amounts of electronically generated orders somehow were included in the Program despite the protections and monitoring described above, the average realized spread measurement would likely reflect that inclusion and act as a disincentive for liquidity providers to participate in the Program. The Exchange's interest, in other words, is aligned directly with its stated intention to monitor compliance with the "substantially all" requirement.

BYX appreciates the opportunity to provide this response to the comments received on its proposal to allow an RMO to attest that "substantially all" orders submitted to the Program will qualify as "Retail Orders," rather than being required to attest that "any order" submitted to the Program will so qualify. Please feel free to contact me if you have any questions in connection with this matter.

Sincerely,

Eric J. Swanson
Senior Vice-President and General Counsel