

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-63930; File No. SR-EDGX-2010-17)

February 18, 2011

Self-Regulatory Organizations; EDGX Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Disapprove a Proposed Rule Change as Modified by Amendment No. 2 to Amend EDGX Rules 11.9 and 11.5 Regarding Step-up Orders

I. Introduction

On November 8, 2010, EDGX Exchange, Inc. (the “Exchange” or “EDGX”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend EDGX Rule 11.9 regarding the description of the Step-up order type<sup>3</sup> and modify Exchange Rule 11.5(c)(7) to allow Mid-Point Match orders<sup>4</sup> entered in response to Step-up orders to be processed pursuant to Exchange Rule 11.9. The proposed rule change was published for comment in the Federal Register on November 24, 2010.<sup>5</sup> On November 23, 2010, the Exchange submitted Amendment No. 1 to the proposed rule change. On December 14, 2010, the Exchange submitted Amendment No. 2 to the proposed rule change, which was published for comment in the Federal Register on December 23, 2010.<sup>6</sup> The Commission received one

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Exchange Rule 11.5(c)(11) defines a “Step-up” order as a “market or limit order with the instruction that the System display the order to Users at or within the NBBO price pursuant to Rule 11.9(b)(1)(C).”

<sup>4</sup> Exchange Rule 11.5(c)(7) defines a “Mid-Point Match” order as an “order with an instruction to execute it at the midpoint of the NBBO.”

<sup>5</sup> See Securities Exchange Act Release No. 63336 (November 18, 2010), 75 FR 71781.

<sup>6</sup> Amendment No. 2 replaced in its entirety the original filing and Amendment No. 1. See Securities Exchange Act Release No. 63574 (December 17, 2010), 75 FR 80876.

comment letter on the proposal,<sup>7</sup> and received the Exchange's response to the comment letter.<sup>8</sup>

This order institutes proceedings pursuant to Section 19(b)(2)(B) of the Act to determine whether to disapprove the proposed rule change, as modified by Amendment No. 2. Institution of disapproval proceedings, however, does not indicate that the Commission has reached any conclusions with respect to any of the issues involved.<sup>9</sup>

## II. Description of the Proposal

Exchange Rule 11.5(c)(11) defines a "Step-up" order as a "market or limit order with the instruction that the System display the order to Users at or within the NBBO price pursuant to Rule 11.9(b)(1)(C)." Exchange Rule 11.9(b)(1)(C), in turn, states that Step-up orders shall be displayed to Users (hereinafter referred to as "Members"),<sup>10</sup> in a manner that is separately identifiable from other Exchange orders, at or within the NBBO price for a period of time not to

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<sup>7</sup> See Letter dated December 15, 2010, from Janet L. McGuinness, Senior Vice President – Legal and Corporate Secretary, Legal & Government Affairs, NYSE Euronext to Elizabeth M. Murphy, Secretary, Commission ("NYSE Euronext Letter"). The NYSE Euronext Letter opposes the proposed rule change and, in so doing, expresses support for the Commission's recent proposal that would eliminate the exception for "flash orders" from Rule 602 of Regulation NMS. See Securities Exchange Act Release No. 60684 (September 18, 2009), 74 FR 48632 (September 23, 2009) (the "Flash Order Proposed Rulemaking").

<sup>8</sup> See Letter dated January 18, 2011, from Eric Hess, General Counsel, DirectEdge Holdings, LLC ("Direct Edge"), to Elizabeth M. Murphy, Secretary, Commission.

<sup>9</sup> As noted above, the Commission has issued a proposed rulemaking that, if adopted, could impact the permissibility of the Step-up orders of the Exchange that are the subject of the proposed rule change. See Flash Order Proposed Rulemaking, *supra* note 7. The Commission emphasizes that this institution of proceedings to determine whether to disapprove the proposed rule change in no way prejudices or otherwise determines what action, if any, the Commission may take with respect to the Flash Order Proposed Rulemaking.

<sup>10</sup> Exchange Rule 1.5(cc) defines a User as "any Member or Sponsored Participant who is authorized to obtain access to the System pursuant to Rule 11.3." Exchange Rule 11.9(b)(1) provides that (prior to display of an order to a User), an incoming order shall first attempt to be matched for execution against orders in the EDGX Book.

exceed five hundred milliseconds, as determined by the Exchange (the “Step-up Display Period”). Step-up orders are intended to permit a Member to initiate a price auction of such orders by displaying order solicitation information to other Members simultaneously, provided such other Members have elected to receive such order information. Under the current rules, the first responsive Member order would execute against the Step-up order.

The Exchange proposes to specify the Step-up Display Period as 10 milliseconds, and eliminate the discretion afforded to the Exchange in its existing Rule to vary the length of the Step-up Display Period. In addition, the Exchange proposes to amend Exchange Rule 11.9(b)(1)(C) to provide that, at the conclusion of the Step-up Display Period, the Step-up order shall execute against responsive Member orders priced at or within the NBBO on a price/time priority basis consistent with Exchange Rule 11.8(a)(1) and (2). The Exchange further proposes that, commencing on the six month anniversary of a Commission approval order, the orders eligible for executing against Step-up orders shall be expanded to include Member orders priced better but not outside the NBBO at the end of the Step-up Display Period that may have entered the Exchange book outside the Step-up process (such orders, “Eligible Book Orders”).<sup>11</sup>

The Exchange also proposes to amend Exchange Rule 11.5(c)(7) to allow Mid-Point Match orders that are entered in response to Step-up orders to participate in the price auction. The Exchange will not accept orders priced in subpennies during Step-up auctions. The Exchange believes a midpoint response will provide an additional mechanism for a Member that is willing to offer price improvement, but is unwilling to cross the spread between the NBBO, to

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<sup>11</sup> Responses are accumulated for the Step-up Display Period by the Exchange, rather than processed at arrival time. Eligible Book Orders will continue to be eligible for execution against the EDGX Book during the Step-up Display Period, as they do currently.

do so. By providing this option, the Exchange believes that a greater proportion of Step-up orders will receive price improvement.

The Step-up order process will not generate an execution if the market is crossed for the security that is the subject of a Step-up order. If the market is crossed, or if there are no responsive Member orders at or within the NBBO, at the end of the Step-up Display Period, the Step-up process shall terminate and the Step-up order shall be cancelled or routed in accordance with the Member's instructions.

### III. Summary of Comments

In its comment letter on the original filing, NYSE Euronext opposes the proposed rule change on several grounds. NYSE Euronext argues that the Step-up auction mechanism will increase the number of orders whose execution is artificially delayed, including both Step-up orders and those responding to them, and thus increase the number of orders missing execution opportunities in other markets. NYSE Euronext also believes that, by proposing to ultimately make Eligible Book Orders eligible for execution against Step-up orders, the proposed rule change would eliminate an Exchange member's choice as to whether its orders will interact with Step-up orders. Finally, NYSE Euronext expresses concern that allowing Mid-Point Match orders to be submitted in response to a Step-up order "further expands the use of [the Exchange's] flash mechanism."<sup>12</sup>

Direct Edge, on behalf of the Exchange, responds that it is not offering an expansion of the flash order type, but rather an auction process that has significant similarities to those used by the NYSE, and notes that the duration of its auction will be the shortest in the securities

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<sup>12</sup> NYSE Euronext Letter, supra note 7, at p. 3. As noted above, NYSE Euronext also expresses support for the Flash Order Proposed Rulemaking. This order addresses only those portions of the NYSE Euronext Letter that specifically address the Exchange's proposed rule change.

markets.<sup>13</sup> Direct Edge further argues that the Step-up auction process creates meaningful price improvement opportunities for investors while helping brokers to satisfy their best execution obligations. Direct Edge also believes that expanding participation in the auction to both Eligible Book Orders and Mid-Point Match orders will both increase price competition and expand member choice.<sup>14</sup>

IV. Proceedings to Determine Whether to Disapprove SR-EDGX-2010-17 and Grounds for Disapproval under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2) of the Act<sup>15</sup> to determine whether the Exchange's proposed rule change should be disapproved. Pursuant to Section 19(b)(2)(B) of the Act,<sup>16</sup> the Commission is providing notice of the grounds for disapproval under consideration. Under the proposal, the Exchange would create a 10 millisecond auction for responding to Step-up orders and would expand the order types able to interact with Step-up orders during the Step-up auction process. The Act and the rules thereunder require, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to not permit unfair discrimination among broker-dealers and customers and, in general, to protect investors and the public interest.<sup>17</sup> The Commission is concerned that the Exchange's proposal may be inconsistent with these standards. Specifically,

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<sup>13</sup> Direct Edge Letter, supra note 8, at p. 2.

<sup>14</sup> See id. at p. 3-4.

<sup>15</sup> 15 U.S.C. 78s(b)(2).

<sup>16</sup> 15 U.S.C. 78s(b)(2)(B). Section 19(b)(2)(B) of the Act also provides that proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. Id. The time for conclusion of the proceedings may be extended for up to 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding. Id.

<sup>17</sup> See 15 U.S.C. 78f(b)(5).

the Commission is concerned about the extent to which a 10 millisecond auction would provide a meaningful opportunity for price improvement, or would materially increase the risk that a Step-Up order will miss an execution. The Commission notes that the Exchange has not provided any data with respect to the impact of its proposed 10 millisecond auction on these issues. The Commission is also concerned about the potential implications of the Step-Up auction process, because Eligible Book Orders would not be able to participate in the Step-Up auction for six-months from the date of a Commission approval order.

In view of the issues raised by the proposal, the Commission has determined to institute disapproval proceedings at this time to determine whether the Commission should disapprove the proposed rule change. Institution of disapproval proceedings does not indicate, however, that the Commission has reached any conclusions with respect to the issues involved. The sections of the Act and the rules thereunder that are applicable to the proposed rule change include:

- Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest, and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers;<sup>18</sup> and
- Section 11A(a) of the Act, in which Congress found that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure “economically efficient execution of securities transactions,” “fair competition among brokers and dealers and among exchange markets,” “the

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<sup>18</sup> 15 U.S.C. 78f(b)(5).

availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities,” and “the practicability of brokers executing investors’ orders in the best market.”<sup>19</sup>

V. Procedure: Request for Written Comments

The Commission requests written views, data, and arguments with respect to the concerns identified above as well as any other relevant concerns. Such comments should be submitted by [insert date 45 days from date of publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 60 days from date of publication in the Federal Register]. Although there do not appear to be any issues relevant to disapproval which would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>20</sup>

The Commission asks that commenters address the merit of the Exchange’s statements in support of the proposal, in addition to any other comments they may wish to submit about the proposed rule change. Interested persons are invited to submit written data, views, and arguments concerning the proposed rule change, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/other.shtml>); or

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<sup>19</sup> 15 U.S.C. 78k-1(a)(1)(C)(i)-(iv).

<sup>20</sup> 15 U.S.C. 78s(b)(2). Section 19(b)(2) of the Act grants the Commission flexibility to determine what type of proceeding -- either oral or notice and opportunity for written comments -- is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-EDGX-2010-17 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-EDGX-2010-17. The file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/other.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer



to File Number SR-EDGX-2010-17 and should be submitted on or before [insert date 45 days from date of publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 60 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>21</sup>

Cathy H. Ahn  
Deputy Secretary

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<sup>21</sup> 17 CFR 200.30-3(a)(57).