

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-69870; File No. SR-EDGX-2013-17)

June 27, 2013

Self-Regulatory Organizations; EDGX Exchange, Inc.; Order Approving a Proposed Rule Change Relating to the EDGX Exchange, Inc.'s Routing Broker Dealer, as Described in EDGX Rule 2.12(b)

I. Introduction

On May 16, 2013, EDGX Exchange, Inc. (“EDGX” or “Exchange”) 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 make permanent the existing pilot program that permits the Exchange’s inbound router, as described in Rule 2.12(b), to receive inbound routes of equities orders through Direct Edge ECN LLC d/b/a DE Route (“DE Route”), the Exchange’s routing broker dealer, from EDGA Exchange, Inc. (“EDGA”). The proposed rule change was published for comment in the Federal Register on May 28, 2013.<sup>3</sup> The Commission received no comment letters regarding the proposed rule change. This order approves the proposed rule change.

II. Background

DE Route is a registered broker-dealer that is a member of the Exchange and is permitted to provide members of EDGA optional routing services to other trading centers.<sup>4</sup> DE Route is

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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> See Securities Exchange Act Release No. 69614 (May 21, 2013), 78 FR 31994 (“Notice”).

<sup>4</sup> DE operates as a facility of EDGA that provides outbound routing from EDGA to other trading centers, subject to certain conditions. See Securities Exchange Act Release No. 61698 (March 12, 2010), 75 FR 13151 (March 18, 2010) (File No. 10-194 and 10-196) (order granting the exchange registration of EDGA and EDGX.) (“Exchange Registration Approval Order”).

owned by Direct Edge Holdings LLC (“DE Holdings”). DE Holdings also owns two registered securities exchanges – the Exchange and EDGA.<sup>5</sup> Thus, DE Route is an affiliate of the Exchange and EDGA.<sup>6</sup>

On May 12, 2010, the Commission approved the Exchange’s application for registration as a national securities exchange.<sup>7</sup> As part of the approval, the Exchange was approved to receive inbound routes of orders that DE Route routes in its capacity as a facility of EDGA on a pilot basis for 12 months.<sup>8</sup> The pilot was originally set to expire on July 1, 2011, but was subsequently extended and is currently set to expire on June 30, 2013.<sup>9</sup> The Exchange now seeks permanent approval of this inbound routing pilot.<sup>10</sup>

### III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>11</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(1) of the Act,<sup>12</sup> which requires, among other things, that a national securities exchange be so organized and have the capacity to carry out the purposes of the Act, and

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<sup>5</sup> See id.

<sup>6</sup> See Exchange Registration Approval Order, 75 FR at 13165 n.219 and accompanying text.

<sup>7</sup> See Exchange Registration Approval Order, 75 FR 13151.

<sup>8</sup> See id.

<sup>9</sup> See Securities Exchange Act Release Nos. 64361 (April 28, 2011), 76 FR 25388 (May 4, 2011) (SR-EDGX-2011-12); and 66644 (March 22, 2012), 77 FR 18877 (March 28, 2012) (SR-EDGX-2012-09).

<sup>10</sup> See Notice, 78 FR 31996.

<sup>11</sup> In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>12</sup> 15 U.S.C. 78f(b)(1).

to comply and enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulation thereunder, and the rules of the Exchange. Further, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>13</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to, and facilitating transactions in securities; 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. Section 6(b)(5) also requires that the rules of an exchange not be designed to permit unfair discrimination among customers, issuers, brokers, or dealers.

Recognizing that the Commission has previously expressed concern regarding the potential for conflicts of interest in instances where a member firm is affiliated with an exchange to which it is routing orders, the Exchange previously implemented limitations and conditions to DE Route's affiliation with the Exchange to permit the Exchange to accept inbound orders that DE Route routes in its capacity as a facility of EDGA, on a pilot basis.<sup>14</sup> The Exchange now seeks to make this pilot permanent, subject to the same limitation and conditions. Specifically, the Exchange committed to the following limitations and conditions:<sup>15</sup>

- The Exchange shall enter into a plan pursuant to Rule 17d-2 under the Exchange Act with a non-affiliated self-regulatory organization (“SRO”) to relieve the Exchange of regulatory responsibilities for DE Route with respect to rules that are common rules

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<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> See Exchange Registration Approval Order, 75 FR at 13165-13166.

<sup>15</sup> See Notice, 78 FR at 31995.

between the Exchange and the non-affiliated SRO, and enter into a regulatory contract (“Regulatory Contract”) with a non-affiliated SRO to perform regulatory responsibilities for DE Route for unique Exchange rules.

- The Regulatory Contract shall require the Exchange to provide the non-affiliated SRO with information, in an easily accessible manner, regarding all exception reports, alerts, complaints, trading errors, cancellations, investigations, and enforcement matters (collectively “Exceptions”) in which DE Route is identified as a participant that has potentially violated Exchange or Commission Rules, and shall require that the non-affiliated SRO provide a report, at least quarterly, to the Exchange quantifying all Exceptions in which DE Route is identified as a participant that has potentially violated Exchange or Commission Rules.
- The Exchange, on behalf of DE Holdings, shall establish and maintain procedures and internal controls reasonably designed to ensure that DE Route does not develop or implement changes to its system on the basis of non-public information regarding planned changes to Exchange systems, obtained as a result of its affiliation with the Exchange, until such information is available generally to similarly situated members of the Exchange in connection with the provision of inbound order routing to the Exchange.<sup>16</sup>

The Exchange states that it has complied with the above-listed conditions during the pilot.<sup>17</sup> The Exchange believes that by meeting such conditions it has set up mechanisms that protect the independence of the Exchange’s regulatory responsibility with respect to DE Route, and has

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<sup>16</sup> The Commission notes that this condition is set forth in EDGX Rule 2.12(a)(3).

<sup>17</sup> See Notice, 78 FR at 31995.

demonstrated that DE Route cannot use any information that it may have because of its affiliation with the Exchange to its advantage.<sup>18</sup>

In the past, the Commission has expressed concern that the affiliation of an exchange with one of its members raises potential conflicts of interest, and the potential for unfair competitive advantage.<sup>19</sup> Although the Commission continues to be concerned about potential unfair competition and conflicts of interest between an exchange's self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members, for the reasons discussed below, the Commission believes that it is consistent with the Act to permit DE Route, in its capacity as a facility of EDGA, to provide inbound routing to the Exchange on a permanent basis instead of a pilot basis, subject to the other conditions described above.<sup>20</sup>

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<sup>18</sup> See id.

<sup>19</sup> See, e.g., Securities Exchange Act Release Nos. 54170 (July 18, 2006), 71 FR 42149 (July 25, 2006) (SR-NASDAQ-2006-006) (order approving Nasdaq's proposal to adopt Nasdaq Rule 2140, restricting affiliations between Nasdaq and its members); 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) (order approving the combination of the New York Stock Exchange, Inc. and Archipelago Holdings, Inc.); 58673 (September 29, 2008), 73 FR 57707 (October 8, 2008) (SR-Amex-2008-62) (order approving the combination of NYSE Euronext and the American Stock Exchange LLC); 59135 (December 22, 2008), 73 FR 79954 (December 30, 2008) (SR-ISE-2009-85) (order approving the purchase by ISE Holdings of an ownership interest in DirectEdge Holdings LLC); and 59281 (January 22, 2009), 74 FR 5014 (January 28, 2009) (SR-NYSE-2008-120) (order approving a joint venture between NYSE and BIDS Holdings L.P.); 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (File No. 10-182) (order granting the exchange registration of BATS Exchange, Inc.); 61698 (March 12, 2010), 75 FR 13151 (March 18, 2010) (File Nos. 10-194 and 10-196) (order granting the exchange registration of EDGX Exchange, Inc. and EDGA Exchange, Inc.); and 62716 (August 13, 2010), 75 FR 51295 (August 19, 2010) (File No. 10-198) (order granting the exchange registration of BATS-Y Exchange, Inc.).

<sup>20</sup> The Commission notes that these limitations and conditions are consistent with those previously approved by the Commission for other exchanges. See, e.g., Securities Exchange Act Release Nos. 64090 (March 17, 2011), 76 FR 16462 (March 23, 2011) (SR-BX-2011-007); 66808 (April 13, 2012), 77 FR 23294 (April 18, 2012) (SR-BATS-2012-013); 66807 (April 13, 2012), 77 FR 23300 (April 18, 2012) (SR-BYX-2012-006); 67256 (June 26, 2012) 77 FR 39277 (July 2, 2012) (SR-BX-2012-030); 69233 (March 25, 2013), 78 FR 19352 (March 29, 2013) (SR-NASDAQ-2013-028); 69232 (March 25,

The Exchange has proposed ongoing conditions applicable to DE Route's inbound routing activities in its capacity as a facility of EDGA, which are enumerated above. The Commission believes that these conditions mitigate its concerns about potential conflicts of interest and unfair competitive advantage. In particular, the Commission believes that a non-affiliated SRO's oversight of DE Route,<sup>21</sup> combined with a non-affiliated SRO's monitoring of DE Route's compliance with the Exchange's rules and quarterly reporting to the Exchange, will help to protect the independence of the Exchange's regulatory responsibilities with respect to DE Route. The Commission also believes that the Exchange's Rule 2.12(a)(3) is designed to ensure that DE Route cannot use any information advantage it may have because of its affiliation with the Exchange.

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2013), 78 FR 19342 (March 29, 2013) (SR-BX-2013-013); and 69229 (March 25, 2013), 78 FR 19337 (March 29, 2013) (SR-Phlx-2013-15).

<sup>21</sup> This oversight will be accomplished through a 17d-2 Agreement. See Approval Order, 75 FR at 13165; and Notice, 78 FR at 31995.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>22</sup> that the proposed rule change (SR-EDGX-2013-17) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>23</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>22</sup> 15 U.S.C. 78s(b)(2).

<sup>23</sup> 17 CFR 200.30-3(a)(12).