

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-78850; File No. SR-BatsEDGX-2016-33)

September 15, 2016

Self-Regulatory Organizations; Bats EDGX Exchange, Inc.; Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt an Options Regulatory Fee

I. Introduction

On July 20, 2016, Bats EDGX Exchange, Inc. (the “Exchange” or “EDGX”) filed with the Securities and Exchange Commission (the “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 adopt an Options Regulatory Fee (“ORF”).<sup>3</sup>

In its filing, EDGX adopted an ORF in the amount of \$0.0002 per contract and proposed to assess the fee to all “customer” range options transactions cleared by Members<sup>4</sup> and non-Members. The proposed rule change was immediately effective upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act.<sup>5</sup> The Commission published notice of

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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. 78452 (August 1, 2016), 81 FR 51951 (August 5, 2016) (“Notice”). The ORF is designed to recover a material portion of the costs to the Exchange for the supervision and regulation of Members’ customer options activity. The Exchange has committed to monitor the amount of revenue collected from the ORF to ensure that it, in combination with its other regulatory fees and fines, does not exceed the Exchange’s total regulatory costs. See id. at 51952.

<sup>4</sup> The term “Member” refers to “any registered broker or dealer that has been admitted to membership in the Exchange.” See EDGX Rule 1.5(n).

<sup>5</sup> 15 U.S.C. 78s(b)(3)(A). A proposed rule change may take effect upon filing with the Commission if it is designated by the exchange as “establishing or changing a due, fee, or other charge imposed by the self-regulatory organization on any person, whether or not the person is a member of the self-regulatory organization.” 15 U.S.C. 78s(b)(3)(A)(ii). Although the proposed rule change was effective upon filing, EDGX indicated that it would not implement the fee until August 1, 2016. See Notice, supra note 3, at 51953.

filing of the proposed rule change in the Federal Register on August 5, 2016.<sup>6</sup> To date, the Commission has not received any comment letters on the Exchange's proposed rule change.

Pursuant to Section 19(b)(3)(C) of the Act, the Commission is hereby: (1) temporarily suspending the proposed rule change; and (2) instituting proceedings to determine whether to approve or disapprove the proposal.

## II. Summary of the Proposed Rule Change

In its proposed rule change filing, EDGX proposed to adopt an ORF in the amount of \$0.0002 per contract side that it would assess on Members and non-Members. Specifically, under the proposal, EDGX would assess the ORF on all options transactions that clear at the Options Clearing Corporation ("OCC") in the "customer" range, regardless of the exchange on which the transaction occurs.<sup>7</sup> Under the proposal, the ORF would apply to all Member and non-Member options transactions that clear at OCC in the "customer" range.<sup>8</sup>

In support of its proposal, the Exchange stated that applying the ORF to non-Members would remove an incentive for Members to clear their trades through non-Members to avoid the obligation to pay the ORF to EDGX.<sup>9</sup> The Exchange further stated that applying the ORF to Member and non-Member customer transactions would prevent options market participants from

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On August 22, 2016, the Exchange submitted a proposed rule change to delay the implementation of the ORF until February 1, 2017. See Securities Exchange Act Release No. 78745 (September 1, 2016), 81 FR 62185 (September 8, 2016) (SR-BatsEDGX-2016-48).

<sup>6</sup> See Notice, supra note 3, at 51951.

<sup>7</sup> See id. at 51952.

<sup>8</sup> See id.

<sup>9</sup> See id.

avoiding becoming a Member of EDGX based on a desire to avoid being assessed the ORF by EDGX.<sup>10</sup>

### III. Suspension of the EDGX Proposal

Pursuant to Section 19(b)(3)(C) of the Act,<sup>11</sup> at any time within 60 days of the date of filing of an immediately effective proposed rule change pursuant to Section 19(b)(1) of the Act,<sup>12</sup> the Commission summarily may temporarily suspend the change in the rules of a self-regulatory organization made thereby if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

The Commission believes it is appropriate in the public interest to temporarily suspend EDGX's proposal to assess the ORF to Member and non-Member customer transactions and solicit comment on and evaluate further whether it is consistent with the Act and the rules and regulations thereunder that are applicable to EDGX.

When exchanges file their proposed rule changes with the Commission, including fee filings like EDGX's present proposal, they are required to provide a statement supporting the proposal's basis under the Act and the rules and regulations thereunder applicable to the exchange.<sup>13</sup> The instructions to Form 19b-4, on which exchanges file their proposed rule

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<sup>10</sup> See id.

<sup>11</sup> 15 U.S.C. 78s(b)(3)(C).

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

<sup>13</sup> See 17 CFR 240.19b-4 (Item 3 entitled "Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change").

changes, specify that such statement “should be sufficiently detailed and specific to support a finding that the proposed rule change is consistent with [those] requirements...”<sup>14</sup>

Among other things, exchange proposed rule changes are subject to Section 6 of the Act, including Section 6(b)(4), which requires the rules of an exchange to “provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities,” and Section 6(b)(5), which requires the rules of an exchange to, among other things, be “not designed to permit unfair discrimination between customers, issuers, brokers, or dealers...”<sup>15</sup>

In justifying its proposal, the Exchange stated in its filing that its proposal is reasonable because the ORF supports the Exchange’s market surveillance programs that evaluate activity across all options markets.<sup>16</sup> EDGX further stated that it analyzes all options market activity in order to effectively meet its statutory obligation to enforce compliance by Members and their associated persons with the Act and the rules of the Exchange.<sup>17</sup> The Exchange also argued that the proposed rule change is equitable and not unfairly discriminatory because it would avoid market participants clearing their transactions through non-Members in order to avoid paying an ORF to EDGX.<sup>18</sup> The Exchange further stated that applying the fee to both Member and non-Member activity will eliminate an incentive for options market participants to make exchange membership decisions based on a desire to avoid paying the ORF to EDGX.<sup>19</sup>

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<sup>14</sup> See id.

<sup>15</sup> 15 U.S.C. 78f(b)(4) and (5), respectively.

<sup>16</sup> See Notice, supra note 3, at 51953.

<sup>17</sup> See id.

<sup>18</sup> See id.

<sup>19</sup> See id.

The Exchange also stated that assessing an ORF on non-Members will allow it to charge an ORF on transactions that were initially submitted for clearing to a clearing broker that is a Member of EDGX, but that were subsequently “flipped” to the account of a non-Member for clearing.<sup>20</sup>

Finally, the Exchange noted that it has heard allegations from market participants that some options exchanges may also assess an ORF on all options transactions cleared by OCC in the customer range regardless of whether such transactions are executed or cleared by an exchange Member.<sup>21</sup> The Commission notes, however, that no rules presently maintained by any exchange currently apply the ORF to non-Members in the manner that EDGX is now proposing.<sup>22</sup>

In temporarily suspending the Exchange’s fee change, the Commission intends to further consider whether assessing the ORF on transactions of non-Members - where no EDGX Member executed or cleared the trade - is consistent with the statutory requirements applicable to a national securities exchange under the Act. In particular, the Commission will consider whether the proposed rule change satisfies the standards under the Act and the rules thereunder requiring, among other things, that an exchange’s rules provide for the equitable allocation of reasonable fees among members, issuers, and other persons using its facilities; not permit unfair discrimination between customers, issuers, brokers or dealers; and do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.<sup>23</sup>

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<sup>20</sup> See id. at 51952.

<sup>21</sup> See id. at 51953.

<sup>22</sup> See id. at note 16 (noting that no options exchange’s current rule text applies in such a manner).

<sup>23</sup> See 15 U.S.C. 78f(b)(4), (5), and (8), respectively.

Therefore, the Commission finds that it is appropriate in the public interest, for the protection of investors, and otherwise in furtherance of the purposes of the Act, to temporarily suspend the proposed rule change.<sup>24</sup>

#### IV. Proceedings to Determine Whether to Approve or Disapprove the EDGX Proposal

In addition to temporarily suspending the proposal, the Commission also hereby institutes proceedings pursuant to Sections 19(b)(3)(C)<sup>25</sup> and 19(b)(2) of the Act<sup>26</sup> to determine whether the Exchange's proposed rule change should be approved or disapproved. Further, pursuant to Section 19(b)(2)(B) of the Act,<sup>27</sup> the Commission is hereby providing notice of the grounds for disapproval under consideration. The Commission believes it is appropriate to institute disapproval proceedings at this time in view of the significant legal and policy issues raised by the proposal. Institution of disapproval proceedings does not indicate, however, that the Commission has reached any conclusions with respect to the issues involved.

As discussed above, pursuant to EDGX's proposal, the Exchange would assess the ORF on Members and non-Members for all of their transactions cleared at OCC in the "customer" range. As noted above, the Act and the rules thereunder require that an exchange's rules, among

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<sup>24</sup> For purposes of temporarily suspending the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>25</sup> 15 U.S.C. 78s(b)(3)(C). Once the Commission temporarily suspends a proposed rule change, Section 19(b)(3)(C) of the Act requires that the Commission institute proceedings under Section 19(b)(2)(B) to determine whether a proposed rule change should be approved or disapproved.

<sup>26</sup> 15 U.S.C. 78s(b)(2).

<sup>27</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. See 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, or if the exchange consents to the longer period. See id.

other things, provide for the equitable allocation of reasonable fees among members, issuers, and other persons using its facilities; not permit unfair discrimination between customers, issuers, brokers or dealers; and not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The Commission solicits comment on whether the Exchange’s ORF fee proposal is consistent with these standards and whether EDGX has sufficiently met its burden in presenting a statutory analysis of how its proposal meets these standards.

In particular, the grounds for possible disapproval under consideration include whether EDGX’s proposal is consistent with the following sections of the Act:

- Section 6(b)(4) of the Act, which requires that the rules of a national securities exchange “provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities;”<sup>28</sup>
- Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange not be “designed to permit unfair discrimination between customers, issuers, brokers, or dealers;”<sup>29</sup> and
- Section 6(b)(8) of the Act, which requires that the rules of a national securities exchange “not impose any burden on competition not necessary or appropriate in furtherance of the purposes of [the Act].”<sup>30</sup>

In particular, the Commission is considering whether a sufficient regulatory nexus exists between the Exchange and a non-Member to justify imposition of the ORF on such non-

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<sup>28</sup> 15 U.S.C. 78f(b)(4).

<sup>29</sup> 15 U.S.C. 78f(b)(5).

<sup>30</sup> 15 U.S.C. 78f(b)(8).

Member. If a non-Member does not execute a trade on EDGX's market, or utilize the services of a Member of EDGX to either execute the trade on another market or clear the trade, then the non-Member would not be utilizing the facilities of the exchange or the services of a Member of the Exchange. Further, the Exchange notes that the ORF would be "designed to recover a material portion of the costs to the Exchange of the supervision and regulation of Members' and non-Member's customer options business, including performing routine surveillances and investigations, as well as policy, rulemaking, interpretive and enforcement activities."<sup>31</sup> The Commission notes, however, that the Exchange's proposed application of the ORF to non-Members raises concerns in that the exercise of an exchange's regulatory jurisdiction and the application of its fee schedule is generally confined to the exchange's Members and persons using its facilities.<sup>32</sup> In other words, EDGX's proposal preliminarily appears to apply a fee that is specifically designed to fund the exchange's regulatory operations in part, by assessing the fee to a class of person over whom the Exchange does not have any direct regulatory responsibility or jurisdiction and who have not directly or indirectly accessed the Exchange's facilities or utilized the services of a Member of the Exchange. Accordingly, the proposal's application of the ORF to non-Members who do not use the facilities of the Exchange or the services of a Member of the Exchange may prevent the Commission from making a finding that the proposal is consistent with the Act and the rules and regulations thereunder.<sup>33</sup>

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<sup>31</sup> See Notice, supra note 3, at 51952.

<sup>32</sup> See, e.g., Section 6(b)(4), which addresses fees that an exchange charges "among its members and issuers and other persons using its facilities." 15 U.S.C. 78f(b)(4).

<sup>33</sup> See 15 U.S.C. 78s(b)(2)(C)(ii) (setting forth the standard for disapproval of a proposed rule change as follows: "The Commission shall disapprove a proposed rule change of a self-regulatory organization if it does not make a finding described in clause (i)."). Section 19(b)(2)(C)(i) provides that "[t]he Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is

V. Commission's Solicitation of 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 21 days from date of publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposal, which are set forth in the Notice,<sup>34</sup> in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the following:

- Commenters' views on the appropriateness of an options exchange assessing an ORF on options transactions executed at an away market that are cleared by OCC in the "customer" range that are neither executed, nor cleared, by a Member of the exchange assessing the ORF;
- Commenters' views on the Exchange's assertion that "there is a strong nexus between the ORF and the Exchange's regulatory activities with respect to its Members', as well as non-Members,' customer trading activity."<sup>35</sup>;
- Commenters' views on the Exchange's argument that "[i]f the ORF did not apply to activity across markets then a non-Member would send their orders to the least cost, least regulated exchange. In addition, applying the fee to all Members' and non-Members' activity across all market [sic] will avoid options participants from terminating their

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consistent with the requirements of [the Act] and the rules and regulations issued under [the Act] that are applicable to such organization."

<sup>34</sup> See Notice, supra note 3.

<sup>35</sup> See id. at 51952.

membership status on or not becoming a [sic] Members of certain exchanges simply to avoid being assessed [sic] ORF.”<sup>36</sup>;

- Whether any other options exchange is currently assessing an ORF on non-Members for their options transactions that are cleared by OCC in the “customer” range in contravention to a stated rule of such exchange; and
- Finally, whether any options exchange currently assesses an ORF on a clearing member that does not ultimately clear a customer transaction, but merely transfers it to the account of a non-Member for clearance and settlement, and, if so, whether doing so is consistent with the current ORF rule text of such options exchange.

Interested persons are invited to submit written data, views, and arguments concerning the proposed rule changes, 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/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-BatsEDGX-2016-33 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-BatsEDGX-2016-33. 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

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<sup>36</sup> See id.

comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.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-BatsEDGX-2016-33 and should be submitted on or before [insert date 21 days from date of publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(3)(C) of the Act,<sup>37</sup> that File No. SR-BatsEDGX-2016-33, be and hereby is, temporarily suspended. In addition, the Commission is instituting proceedings to determine whether the proposed rule change should be approved or disapproved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>38</sup>

Robert W. Errett  
Deputy Secretary

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<sup>37</sup> 15 U.S.C. 78s(b)(3)(C).

<sup>38</sup> 17 CFR 200.30-3(a)(57) and (58).