

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79838; File No. SR-BatsEDGX-2017-05)

January 18, 2017

Self-Regulatory Organizations; Bats EDGX Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change to EDGX Rule 21.19, Bats Auction Mechanism, as it Applies to the Equity Options Platform

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that, on January 13, 2017, Bats EDGX Exchange, Inc. (the “Exchange” or “EDGX”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and, for the reasons discussed below, is approving the proposal on an accelerated basis.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange filed a proposal for the Exchange’s equity options platform (“EDGX Options”) concerning a price improvement mechanism operated by EDGX Options, the Bats Auction Mechanism (“BAM” or “BAM Auction”), which was recently approved by the Commission.<sup>3</sup> A specific aspect of BAM is currently operating on a pilot basis (“Pilot”), which is set to expire on January 18, 2017.<sup>4</sup> The Pilot concerns the fact that there is no minimum size requirement for orders to be eligible for a BAM Auction, as described below. The Exchange seeks to make the Pilot permanent but does not propose any other changes to BAM.

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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. 79718 (January 3, 2017) (SR-BatsEDGX-2016-41).

<sup>4</sup> See id.

The text of the proposed rule change is available at the Exchange's website at [www.bats.com](http://www.bats.com), at the principal office of the Exchange, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of this filing is to make permanent an aspect of BAM that is operating as a Pilot by removing Interpretation and Policy .05 from Rule 21.19.

Background

The Exchange proposed BAM in September of 2016 as a price improvement mechanism on the Exchange.<sup>5</sup> The Proposal was amended by the Exchange on December 15, 2016,<sup>6</sup> and approved, as amended, on January 3, 2017.<sup>7</sup> BAM Auctions were launched on the Exchange effective January 4, 2017. BAM includes functionality in which a Member (an "Initiating Member") may electronically submit for execution an order it represents as agent on behalf of a

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<sup>5</sup> See Securities Exchange Act Release No. 78988 (September 29, 2016), 81 FR 69172 (October 5, 2016) (SR-BatsEDGX-2016-41) ("Proposal").

<sup>6</sup> See supra, note 3; see also SR-BatsEDGX-2016-41 Amendment No. 1, available at: [http://www.bats.com/us/options/regulation/rule\\_filings/edgx/](http://www.bats.com/us/options/regulation/rule_filings/edgx/).

<sup>7</sup> See supra, note 3.

Priority Customer,<sup>8</sup> broker dealer, or any other person or entity (“Agency Order”) against principal interest or against any other order it represents as agent (an “Initiating Order”) provided it submits the Agency Order for electronic execution into the BAM Auction pursuant Rule 21.19. All options traded on EDGX Options are eligible for BAM.

#### Pilot Program

One component of BAM as approved by the Commission is currently operating as a Pilot, which is set to expire on January 18, 2017. The Pilot concerns that there is no minimum size requirement for orders to be eligible for a BAM Auction. The Exchange now seeks to remove Interpretation and Policy .05 from Rule 21.19 so that the Pilot may operate on a permanent basis.

Pursuant to the Pilot, there is no minimum size requirement for orders to be eligible for a BAM Auction. During this Pilot, the Exchange agreed to submit certain data, periodically as required by the Commission, to provide supporting evidence that, among other things, there is meaningful competition for all size orders and that there is an active and liquid market functioning on the Exchange outside of the Auction mechanism. The Exchange proposed to adopt this provision on a pilot basis based on the fact that multiple other options exchanges have a similar provision with respect to their own price improvement mechanisms and such provisions have been operating on a pilot basis.<sup>9</sup> Although the Exchange only recently launched BAM and

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<sup>8</sup> The term “Priority Customer” means any person or entity that is not: (A) a broker or dealer in securities; or (B) a Professional. The term “Priority Customer Order” means an order for the account of a Priority Customer. See Rule 16.1(a)(45). A “Professional” is any person or entity that: (A) is not a broker or dealer in securities; and (B) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). All Professional orders shall be appropriately marked by Options Members. See Rule 16.1(a)(46).

<sup>9</sup> See, e.g., Securities Exchange Act Release Nos. 53222 (February 3, 2006), 71 FR 7089 (February 10, 2006) (SR-CBOE-2005-60) (order approving the CBOE AIM price

does not yet have meaningful data to analyze pursuant to the Pilot, the Exchange is proposing to make the Pilot permanent based on the recent filings by multiple other options exchanges to make analogous provisions permanent.<sup>10</sup> The Exchange believes that BAM is sufficiently similar to these processes that there is no need to continue the Pilot in light of the recent filings to operate similar processes on a permanent basis. In particular, based on the rules discussed in additional detail below as well as the results of similar mechanisms operated by several other options exchanges, the Exchange believes that there will be meaningful competition in BAM for auctions of all sizes, that there will continue to be an active and liquid market functioning on the Exchange outside of the auction mechanism, and that there will be opportunities for price improvement for orders executed through BAM.

The Exchange believes BAM process will promote meaningful competition because it is open to all Members of the Exchange and, thus, all Members will have an equal opportunity to respond with their best prices during a BAM Auction. Since the Exchange considers all interest present in the Exchange's system, and not solely BAM responses, for execution against Agency

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improvement mechanism, including that there is no minimum size requirement on a pilot basis); 73590 (November 13, 2014), 79 FR 68919 (November 19, 2014) (SR-MIAX-2014-56) (order approving the MIAX PRIME price improvement mechanism, including that there is no minimum size requirement on a pilot basis); 76301 (October 29, 2015), 80 FR 68347 (November 4, 2015) (SR-BX-2015-032) (order approving the NASDAQ BX PRISM price improvement mechanism, including that there is no minimum size requirement on a pilot basis).

<sup>10</sup> See, e.g., Securities Exchange Act Release Nos. 79499 (December 7 2016), 81 FR 90012 (December 13, 2016) (SR-CBOE-2016-084) (proposal to modify the CBOE AIM price improvement mechanism including the proposal to make the process permanent, specifically that there is no minimum size requirement); 79500 (December 7, 2016), 81 FR 90030 (December 13, 2016) (SR-MIAX-2016-46) (proposal to modify the MIAX PRIME price improvement mechanism including the proposal to make the process permanent, specifically that there is no minimum size requirement); 79465 (December 5, 2016), 81 FR 79465 [sic] (December 9, 2016) (SR-BX-2016-063) (proposal to modify certain aspects of the NASDAQ BX PRISM price improvement mechanism including the proposal to make the process permanent, including that there is no minimum size requirement).

Orders, those participants who are not explicit responders to a BAM Auction will expect executions via BAM as well.<sup>11</sup> Further, once an Initiating Member has submitted an Agency Order for processing in a BAM Auction, such Agency Order may not be modified or cancelled.<sup>12</sup> In addition, the Exchange believes there will be meaningful competition because an Initiating Order may not be a solicited order for the account of any market maker on EDGX Options (“Options Market Maker”) assigned in the affected series on the Exchange.<sup>13</sup> Thus, such Options Market Makers assigned in the affected series will presumably be actively quoting in such series, and participate in BAM as unrelated orders, and/or will be responding to BAM Auctions in such series.

Similarly, the Exchange believes there will continue to be an active and liquid market functioning on the Exchange outside of the auction mechanism for the same reason noted above, namely that an Initiating Order may not be a solicited order for the account of an Options Market Maker.<sup>14</sup> In addition, resting quotes and orders that were at a price that is equal to the NBBO on the opposite side of the market from the Agency Order (“Priority Orders”) would have priority up to their size in the NBBO at the time an Auction is initiated (“Initial NBBO”) at each price level at or better than such Initial NBBO after Priority Customer and the Initiating Member have received allocations.<sup>15</sup> Thus, the concept of Priority Orders is intended to incentivize active participation on the EDGX Options order book outside of BAM Auctions.

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<sup>11</sup> See Exchange Rule 21.19(b)(3).

<sup>12</sup> See Exchange Rule 21.19(b)(1)(A).

<sup>13</sup> See Exchange Rule 21.19(a)(6).

<sup>14</sup> See id.

<sup>15</sup> See Exchange Rule 21.19(b)(4)(B)(iii).

Finally, the Exchange believes that there will be opportunities for price improvement for orders executed through BAM, including for smaller sized Agency Orders when the difference between the NBB and NBO is \$0.01. Pursuant to BAM, if any Agency Order is for less than 50 option contracts and the difference between the NBB and NBO is \$0.01, the Initiating Member must stop the entire Agency Order at one minimum price improvement increment better than the NBBO, which increment shall be determined by the Exchange but may not be smaller than \$0.01.<sup>16</sup> Thus, even for an Agency Order that may be less likely to receive price improvement as compared to other Agency Orders, namely a smaller order when the spread is one penny wide, the rules of BAM require that such order will receive price improvement.

Based on the foregoing, the Exchange believes it is appropriate to continue the no minimum size requirement on a permanent basis.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.<sup>17</sup> In particular, the proposal is consistent with Section 6(b)(5) of the Act<sup>18</sup> because it would promote just and equitable principles of trade, remove impediments to, and perfect the mechanism of, a free and open market and a national market system.

Specifically, the Exchange believes that BAM, including the Pilot, results in increased liquidity available at improved prices, with competitive final pricing out of the Initiating Member's complete control. The Exchange believes that BAM promotes and fosters

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<sup>16</sup> See Exchange Rule 21.19(a)(1)(A).

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

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

competition and affords the opportunity for price improvement to more options contracts. The Exchange believes that allowing BAM to continue without a minimum size requirement is consistent with the Act based on similar pilots operated by other options exchanges with respect to similar price improvement mechanisms and the recent filings to operate such mechanisms and certain aspects thereof on a permanent basis.<sup>19</sup> In addition, the Exchange believes that the rules governing BAM, as adopted, will ensure: (i) that there is meaningful competition in BAM for auctions of all sizes;<sup>20</sup> (ii) that there continues to be an active and liquid market functioning on the Exchange outside of the auction mechanism;<sup>21</sup> and (iii) that there will be opportunities for price improvement for orders executed through BAM.<sup>22</sup> The Exchange notes that this proposal does not propose any new policies or provisions that are unique or unproven, but instead relates to the continuation of a program that briefly operated on a pilot basis.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. In this regard, the Exchange notes that the rule change is being proposed in order to continue BAM without a minimum size requirement. BAM itself was a competitive response to analogous programs offered by other options exchanges but was only recently approved and launched. At the same time, other options exchanges that have been operating similar price improvement mechanisms for longer periods of time recently filed to operate such mechanisms on a permanent basis, including with regard to the fact that such mechanisms do not have a minimum size

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<sup>19</sup> See supra, note 10.

<sup>20</sup> See supra, notes 11-13 and accompanying text.

<sup>21</sup> See supra, notes 14-15 and accompanying text.

<sup>22</sup> See supra, note 16 and accompanying text.

requirement.<sup>23</sup> Accordingly, the Exchange's proposal to operate BAM without a minimum size requirement is a competitive proposal and the Exchange believes this proposed rule change is necessary to permit fair competition among the options exchanges.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any written comments from members or other interested parties.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, 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-2017-05 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-2017-05. This 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/sro.shtml>). Copies

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<sup>23</sup> See *supra*, note 10.



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 available publicly. All submissions should refer to File Number SR-BatsEDGX-2017-05, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

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 and, in particular, with Section 6(b) of the Act.<sup>24</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>25</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,

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<sup>24</sup> 15 U.S.C. 78f(b). In approving this 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. 78f(b)(5).

clearing, settling, 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 customers, issuers, brokers and dealers.

The Commission notes that BAM is designed to provide customers with an opportunity for price improvement to orders, including orders of fewer than 50 contracts. The Commission also notes that BAM currently requires price improvement for Agency Orders of fewer than 50 contracts when the NBBO has a bid/ask differential of \$0.01, a situation in which an Agency Order may be less likely to receive price improvement due to the limited spread.<sup>26</sup> In addition, the Commission notes that BAM is designed to encourage competition and promote an active and liquid market outside of BAM. Specifically, the Commission notes that the Exchange's rules provide for broad participation in BAM,<sup>27</sup> promote market maker participation by prohibiting an Initiating Order from being a solicited order for the account of a market maker assigned in the affected series,<sup>28</sup> and encourage competitive quoting outside BAM by providing Priority Order status in a BAM Auction.<sup>29</sup> Finally, the Commission notes that the rules governing EDGX's BAM are similar to those governing auction mechanisms operating at other options exchanges.<sup>30</sup> Thus, the Commission has determined to approve the Exchange's proposal

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<sup>26</sup> See Exchange Rule 21.19(a)(1)(A). Other options exchanges with price improvement auctions have provided data to the Commission demonstrating that such orders receive relatively small amounts of price improvement. See, e.g., Securities Exchange Act Release No. 79465 (December 5, 2016), 81 FR 89167, 89169 (December 9, 2016) (SR-BX-2016-063).

<sup>27</sup> See, e.g., Exchange Rule 21.19(b)(3).

<sup>28</sup> See Exchange Rule 21.19(a)(6).

<sup>29</sup> See Exchange Rule 21.19(b)(4)(B)(iii).

<sup>30</sup> See, e.g., CBOE Rule 6.74A and Chapter VI, Section 9 of the BX Options Rules. These rules have also been operating on a pilot basis, which the exchanges have similarly proposed to make permanent. See *supra* note 10. The Commission notes that, in conjunction with EDGX's proposal, it is approving comparable pilot programs in effect

to approve the Pilot on a permanent basis.

The Exchange has requested that the Commission find good cause for approving the proposed rule change prior to the 30th day after publication of the notice thereof in the Federal Register. The Exchange stated that accelerated approval of its proposal would allow the applicable rules to remain in effect following the expiration of the Pilot on January 18, 2017, which would provide certainty to members of the Exchange because it will allow BAM to continue on the Exchange uninterrupted. For this reason, the Commission believes that good cause exists for accelerated approval of the proposed rule change. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>31</sup> to approve the proposed rule change prior to the 30th day after the date of publication of the notice of filing thereof in the Federal Register.

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on other options exchanges. See e.g., Securities Exchange Act Release No. 79812 (January 17, 2017) (SR-BOX-2016-58).

<sup>31</sup> 15 U.S.C. 78s(b)(2).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>32</sup> that the proposed rule change (SR-BatsEDGX-2017-05) be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>33</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>32</sup> 15 U.S.C. 78s(b)(2).

<sup>33</sup> 17 CFR 200.30-3(a)(12).