

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-63989; File No. SR-EDGX-2011-04)

February 28, 2011

Self-Regulatory Organizations; EDGX Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend EDGX Rules 11.5, 11.9, and 11.15 to Make Certain Changes Consistent with the Upcoming Implementation of Amendments to Regulation SHO

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 February 25, 2011 the EDGX Exchange, Inc. (the “Exchange” or the “EDGX”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which items have been substantially prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend EDGX Rules 11.5, 11.9, and 11.15 to make certain changes consistent with the upcoming implementation of amendments to Regulation SHO.<sup>3</sup> The text of the proposed rule change is attached as Exhibit 5 and is available on the Exchange’s website at [www.directedge.com](http://www.directedge.com), at the Exchange’s principal office, and at the Public Reference Room of the Commission.

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

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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> 17 CFR 242.200(g); 17 CFR 242.201.

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 IV below. The self-regulatory organization 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

On February 26, 2010, the Commission adopted amendments to Regulation SHO under the Act in the form of Rule 201,<sup>4</sup> pursuant to which, among other things, short sale orders in covered securities<sup>5</sup> generally cannot be executed or displayed by a trading center<sup>6</sup> such as EDGX at a price that is at or below the current national best bid

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<sup>4</sup> See Securities Exchange Act Release No. 61595 (February 26, 2010), 75 FR 11232 (March 10, 2010). In connection with the adoption of Rule 201, Rule 200(g) of Regulation SHO was also amended to include a "short exempt" marking requirement. The amendments to Rule 201 and Rule 200(g) have a compliance date of February 28, 2011. See Securities Exchange Act Release No. 63247 (November 4, 2010), 75 FR 68702 (November 9, 2010). See also Division of Trading & Markets: Responses to Frequently Asked Questions Concerning Rule 201 of Regulation SHO.

<sup>5</sup> Rule 201(a)(1) defines the term "covered security" to mean any "NMS stock" as defined under Rule 600(b)(47) of Regulation NMS. Rule 600(b)(47) of Regulation NMS defines an "NMS stock" as "any NMS security other than an option." Rule 600(b)(46) of Regulation NMS defines an "NMS security" as "any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options." 17 CFR 242.201(a)(1); 17 CFR 242.600(b)(46); and 17 CFR 242.600(b)(47).

<sup>6</sup> Rule 201(a)(9) states that the term "trading center" shall have the same meaning as in Rule 600(b)(78) of Regulation NMS. Rule 600(b)(78) defines a "trading center" as "a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange

("NBB")<sup>7</sup> when a short sale circuit breaker is in effect for the covered security (the "short sale price test restriction").<sup>8</sup> In anticipation of the upcoming February 28, 2011 compliance date for Rule 201, the Exchange is proposing to amend certain EDGX rules to describe the manner in which the System<sup>9</sup> will handle short sell orders when a short sale price test restriction is triggered under Rule 201 of Regulation SHO. These changes include establishing a definition for "short sale price sliding," which is a new form of price sliding<sup>10</sup> the Exchange proposes to offer when the amendments to Regulation SHO become operative, modifying certain EDGX rules regarding order execution and routing when a short sale price test restriction is in effect, and modifying EDGX rules related to order marking requirements.

The Exchange proposes to offer a new form of price sliding, short sale price sliding, which will be defined in EDGX Rule 11.5(c)(4). As a default, the Exchange will

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market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent." 17 CFR 242.600(b)(78).

<sup>7</sup> Rules 201(a)(4) defines the term "national best bid" to have the same meaning as in Rule 600(b)(42) of Regulation NMS. 17 CFR 242.600(b)(42).

<sup>8</sup> 17 CFR 242.201(b)(1). See also Division of Trading & Markets: Responses to Frequently Asked Questions Concerning Rule 201 of Regulation SHO, Q&A Nos. 2.1 and 2.2 (concerning the duration of a short sale price test restriction).

<sup>9</sup> The "System" is defined in EDGX Rule 1.5(aa) as "the electronic communications and trading facility designated by the Board through which securities orders of Users are consolidated for ranking, execution and, when applicable, routing away."

<sup>10</sup> The Exchange currently offers a process called "displayed price sliding process," as defined in current EDGX Rule 11.5(c)(4), which re-prices and/or displays orders at permissible prices when such orders would lock or cross Protected Quotations in a manner inconsistent with Rule 610(d) of Regulation NMS.

subject a User's<sup>11</sup> EDGX Only Orders to the short sale price sliding in proposed Rule 11.5(c)(4)(B) unless they affirmatively choose to opt-out of the process. As proposed, when a User opts out of the short sale price sliding process, any short sale order that could not be executed or displayed due to a short sale price test restriction would be rejected or cancelled by the Exchange upon entry or while resting on the order book, respectively. When a User's EDGX Only Order is subject to the short sale price sliding process, as proposed in Rule 11.5(c)(4)(B), if it cannot be executed or displayed at the time of entry due to a short sale price test restriction, it will be re-priced by the System to prevent execution or display at or below the current NBB to comply with Rule 201(b)(1)(i).<sup>12</sup> Any EDGX Only Order subject to such re-pricing by the System will be re-priced to display at one minimum price variation ("MPV") above the current NBB ("Permitted Price"). The order will receive a new timestamp when it is re-priced. Following the initial adjustment provided for in proposed Rule 11.5(c)(4)(B), the EDGX Only Order will, to reflect declines in the NBB, continue to be re-priced at the lowest Permitted Price down to the order's original limit price, or if a market order, until the order is filled. The order will receive a new timestamp each time it is re-priced. Alternatively, following the initial adjustment provided for in Rule 11.5(c)(4)(B), the EDGX Only Order may, in accordance with the User's instructions, provided that in all cases the display of such lower prices does not violate Rule 201 of Regulation SHO: (i) be re-priced one additional time to a price that is above the current NBB but equal to the

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<sup>11</sup> A "User" is defined in EDGX Rule 1.5(cc) as any member or sponsored participant of the Exchange who is authorized to obtain access to the System.

<sup>12</sup> Any execution or display will also need to be in compliance with applicable rules regarding minimum pricing increments. 17 CFR 242.612.

NBB at the time the EDGX Only Order was received and receive a new timestamp; or (ii) not be adjusted further. In the event the NBB changes such that the price of a Non-Displayed Order, as defined in EDGX Rule 11.5(c)(8), subject to short sale price sliding would lock or cross the NBB, the Non-Displayed Order will receive a new timestamp, and will be re-priced by the System to a Permitted Price, again in compliance with Rule 201(b)(1)(i).<sup>13</sup>

As proposed, EDGX Only Orders marked “short exempt” will not be subject to short sale price sliding. Certain displayed short sale orders will not be re-priced by the System after entry because under Rule 201(b)(1)(iii)(A) a trading center’s policies and procedures must be reasonably designed to permit the execution of short sale orders of covered securities that were displayed at a price above the current NBB at the time of initial display. “Short exempt” orders also will not be re-priced by the System, but instead, the Exchange will execute, display and/or route such orders without regard to whether the order is at a price less than or equal to the NBB or any short sale price test restriction in effect under Regulation SHO, as described below.

The Exchange also proposes to amend its Rule 11.9 to make clear that it will execute, display and route an order consistent with Rule 201 of Regulation SHO, and that if it cannot do so, orders will be cancelled back to the applicable User. In addition, the Exchange proposes to make clear that it will not route orders away from the Exchange that are marked “short” if a short sale price test restriction is in effect for the covered security. Instead, such orders, if immediate-or-cancel (“IOC”) will be cancelled, and all

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<sup>13</sup> See Division of Trading & Markets: Responses to Frequently Asked Questions Concerning Rule 201 of Regulation SHO, Q&A No. 4.1 (concerning un-displayed orders).

other orders will be posted to the EDGX Book,<sup>14</sup> treated as if they are EDGX Only Orders, as defined in Rule 11.5(c)(4), and subjected to the short sale price sliding process.<sup>15</sup>

Finally, current Rule 11.15 requires Users to identify short sale orders as “short” when entered into the System. The Exchange proposes to add the term “short exempt” to Rule 11.15 because pursuant to amended Rule 200(g) of Regulation SHO, a broker-dealer can mark a short sale order as either “short” or “short exempt.”<sup>16</sup> The Exchange also proposes to make clear in Rule 11.15 that if an order it received is marked “short exempt,” the Exchange will execute, display and/or route the order without regard to whether the order is at a price less than or equal to the NBB or any short sale price test restriction in effect under Regulation SHO.<sup>17</sup> The Exchange also proposes to make clear, as it does in Rule 11.5(d)(1) with respect to intermarket sweep orders, that it relies on a Member’s<sup>18</sup> marking of an order, in this case the “short exempt” marking, when handling such order. Accordingly, proposed Rule 11.15 states that it is the entering Member’s

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<sup>14</sup> As defined in EDGX Rule 1.5(d).

<sup>15</sup> Like with an EDGX Only Order, a User can affirmatively choose to opt-out of the short sale price sliding process.

<sup>16</sup> 17 CFR 242.200(g)(2). Under Rule 200(g)(2), an order may be marked “short exempt” if the broker-dealer had a reasonable basis for believing that the order meets one of the exceptions specified in Rule 201(d) of Regulation SHO or if it is entered during a Short Sale Period and meets the conditions specified in Rule 201(c) of Regulation SHO. *See* 17 CFR 242.201(d); 17 CFR 242.201(c); *See* Division of Trading & Markets: Responses to Frequently Asked Questions Nos. 4.2, 5.4 and 5.5.

<sup>17</sup> 17 CFR 242.201(b)(1)(iii)(B).

<sup>18</sup> A Member is defined in EDGX Rule 1.5(l) as any registered broker or dealer, or any person associated with a registered broker or dealer, that has been admitted to membership in the Exchange.

responsibility, not the Exchange's responsibility, to comply with the requirements of Regulation SHO relating to marking of orders as "short exempt."<sup>19</sup>

## 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>20</sup> In particular, the proposed change is consistent with Section 6(b)(5) of the Act,<sup>21</sup> because it would promote just and equitable principles of trade, and, in general, protect investors and the public interest. The Exchange believes that the proposed changes will provide clarity on the short sale order handling procedures employed by the Exchange and certain obligations of Members when sending short sale orders to the Exchange consistent with Regulation SHO, as amended. The Exchange also believes that the proposed short sale price sliding functionality will assist Users in executing or displaying their orders consistent with Regulation SHO, especially under fast moving conditions where the national best bid/offer is quickly updating. In addition, as is currently the case, the short sale price sliding process is optional to Users. Specifically, Users can choose to opt-out of the short sale price sliding process, and if they choose to do so, the Exchange will cancel back their orders when such orders contradict the provisions of Regulation SHO.

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<sup>19</sup> 17 CFR 242.200(g)(2). See also 17 CFR 242.201(c); 17 CFR 242.201(d). See also Division of Trading and Markets: Responses to Frequently Asked Questions Concerning Rule 201 of Regulation SHO, Q&A Nos. 4.2, 5.4, and 5.5.

<sup>20</sup> 15 U.S.C. 78f(b).

<sup>21</sup> 15 U.S.C. 78f(b)(5).

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

The proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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 unsolicited written comments from members or other interested parties.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>22</sup> and Rule 19b-4(f)(6)(iii) thereunder.<sup>23</sup>

A proposed rule change filed under Rule 19b-4(f)(6)<sup>24</sup> normally does not become operative prior to 30 days after the date of the filing.<sup>25</sup> However, pursuant to Rule

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<sup>22</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>23</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>24</sup> 17 CFR 240.19b-4(f)(6).

<sup>25</sup> 17 CFR 240.19b-4(f)(6)(iii). In addition, Rule 19b-4(f)(6)(iii) requires that a self regulatory organization submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

19b4(f)(6)(iii),<sup>26</sup> the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that it may implement the change no later than February 28, 2011 to coincide with the compliance date for the amendments to Rules 200(g) and 201 of Regulation SHO. The Commission believes that waiving the 30-day operative delay is consistent with the protection of the investors and the public interest because such waiver would ensure compliance with the Commission's amendments to Rules 200(g) and 201 of Regulation SHO. For this reason, the Commission designates the proposed rule change to be operative upon filing with the Commission<sup>27</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change 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.

#### IV. 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

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<sup>26</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>27</sup> For the purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-EDGX-2011-04 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-2011-04. 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 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 20549-1090, 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 and on its Internet website at [www.directedge.com](http://www.directedge.com). 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-EDGX-2011-04 and should be submitted by [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>28</sup>

Cathy H. Ahn  
Deputy Secretary

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<sup>28</sup> 17 CFR 200.30-3(a)(12).