

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66713; File No. SR-EDGX-2012-08)

April 2, 2012

Self-Regulatory Organizations; EDGX Exchange, Inc.; Notice of Filing of Proposed Rule Change Relating to Amendments to Rule 2.11 that Establish the Authority to Cancel Orders and Describe the Operation of an Error Account

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 22, 2012, EDGX Exchange, Inc. (“Exchange” or “EDGX”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III 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.

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

The Exchange proposes to amend Rule 2.11 to (1) add a new subparagraph (a)(6) that addresses the authority of the Exchange and its routing broker-dealer, Direct Edge ECN LLC d/b/a DE Route (“DE Route”) to cancel orders if and when a systems, technical or operational issue (herein, each individually referred to as a “Systems Issue”, and collectively referred to as “Systems Issues”) occurs, and (2) amend subparagraph (a)(4) and add new subparagraph (a)(7) to describe the operation of an error account for DE Route. The text of the proposed rule change is available on the Exchange’s website, at the Exchange’s principal office and in the Public Reference Room of the Commission.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 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

The Exchange proposes to amend Rule 2.11 by adding subparagraph (a)(6) to address the authority of the Exchange and DE Route to cancel orders when a Systems Issue occurs, and by amending subparagraph (a)(4) and adding subparagraph (a)(7) to describe the conditions under which DE Route may maintain and use an error account.³

DE Route is the approved outbound router of EDGX,⁴ subject to the conditions listed in Rule 2.11. EDGX relies on DE Route to provide outbound routing services from EDGX to external market centers (each, a “Trading Center”⁵). The Exchange has also been approved to receive inbound routes of equities orders by DE Route from EDGA Exchange, Inc. for a pilot

³ DE Route is a facility of the Exchange. Accordingly, under Exchange Rule 2.11(a)(1), the Exchange is responsible for filing with the Commission rule changes and fees relating to DE Route’s outbound router function. In addition, EDGX is using the phrase “the Exchange or DE Route” in this rule filing to reflect the fact that a decision to cancel orders affected by Systems Issue may be made by the Exchange or DE Route depending on where those orders are located at the time of that decision.

⁴ See Securities Exchange Act Release No. 61698 (March 12, 2010), 75 FR 13151 (March 18, 2010).

⁵ As defined in EDGX Rule 2.11(a) and Rule 600(b)(78) of Regulation NMS under the Securities Exchange Act of 1934 (the “Act”), 17 CFR 242.600(b)(78).

period ending on June 30, 2012.⁶ When DE Route routes orders to a Trading Center, it does so by sending a corresponding order in its own name to the Trading Center. From time to time, the Exchange and DE Route encounter situations in which it becomes necessary to cancel orders and resolve an error position.⁷

Circumstances That Could Lead to Cancelled Orders

A Systems Issue may arise at DE Route, a Trading Center or the Exchange that may cause the Exchange or DE Route to take steps to cancel orders if the Exchange or DE Route determines that such action is necessary to maintain a fair and orderly market. The examples set forth below describe some of the circumstances in which the Exchange or DE Route may decide to cancel orders.

Example 1. If DE Route or a Trading Center experiences a Systems Issue that results in DE Route not receiving responses to immediate or cancel (“IOC”) orders that it sent to the Trading Center, and that issue is not resolved in a timely manner, DE Route may need to cancel the routed orders affected by the issue.⁸ For instance, if DE Route experiences

⁶ See Release No. 61698 at n. 4. See also Securities Exchange Act Release No. 64361 (April 28, 2011), 76 FR 25388 (May 4, 2011) (SR-EDGX-2011-12); see also SR-EDGX-2012-09 (March 16, 2012) (pending filing to extend the pilot period through June 30, 2013).

⁷ The examples described in this filing are not intended to be exclusive. Proposed subparagraph (a)(6) of EDGX Rule 2.11 would provide general authority for the Exchange or DE Route to cancel orders in order to maintain fair and orderly markets when Systems Issues are occurring, and proposed subparagraph (a)(7) of Rule 2.11 would set forth the manner in which an error position may be handled by DE Route. The proposed rule changes are not limited to addressing order cancellation or an error position resulting only from the specific examples described in this filing.

⁸ In a normal situation (i.e., one in which a Systems Issue does not exist), DE Route should receive an immediate response to an IOC order from a Trading Center, and would pass the resulting fill or cancellation on to the Member. After submitting an order that is routed to a Trading Center, if a Member sends an instruction to cancel that order, the cancellation is held by the Exchange until a response is received from the Trading Center.

a connectivity issue affecting the manner in which it sends or receives order messages to or from Trading Centers, it may be unable to receive timely execution or cancellation reports from the Trading Centers, and DE Route may consequently seek to cancel the affected routed orders. Once a decision is made to cancel those routed orders, any cancellation that a Member submitted to the Exchange on its initial order during such a situation would be honored.⁹

Example 2. If the Exchange experiences a Systems Issue, the Exchange may take steps to cancel all outstanding orders affected by that issue and notify affected Members of the cancellations. In those cases, the Exchange would seek to cancel, via DE Route, any routed orders related to the Members' initial orders.

Circumstances That Could Lead to an Error Position

An error position can arise out of Systems Issues experienced by DE Route, the Exchange or a Trading Center. Connectivity and order processing related issues are the most common types of Systems Issues that DE Route would expect could result in an error position. Connectivity issues, for example, would entail problems with the manner in which DE Route sends or receives order, execution and cancellation messages to or from other Trading Centers. Connectivity issues could arise either from DE Route's systems or from the Trading Center's systems. For example, if DE Route's connection to a Trading Center is interrupted after delivering an order, DE Route may be unable to receive a timely execution report from the Trading Center, and as a consequence may cancel the Member's order. But DE Route may later

For instance, if the Trading Center executes that order, the execution would be passed on to the Member and the cancellation instruction would be disregarded.

⁹ If a Member did not submit a cancellation to the Exchange, however, that initial order would remain "live" and thus be eligible for execution or posting on the Exchange, and neither the Exchange nor DE Route would treat any execution of that initial order or any subsequent routed order related to that initial order as an error position.

discover after the connection was restored that the order was actually executed by the Trading Center, resulting in an error position. Similarly, if the Trading Center attempted to cancel all open orders that it had previously accepted due to a Systems Issue, but either transmitted cancellations on orders that had previously been executed, or subsequently submitted executions of the orders to The Depository Trust Clearing Corporation (“DTCC”) for clearance and settlement, an error position would result.

An error position might also result if DE Route failed to process order messages correctly. For example, if DE Route’s connection to the Exchange is temporarily interrupted and DE Route were to erroneously re-route orders that had previously been executed after the connection was restored, DE Route will have received executions of orders where there were effectively no corresponding orders on the Exchange. In this case, the executions would not necessarily be nullified since DE Route is a regular member of other Trading Centers and is therefore subject to those venues’ policies for honoring trades.¹⁰

A Systems Issue experienced by the Exchange could also result in an error position relating to a routed order. For example, if an order were routed from the Exchange to a Trading Center by DE Route, and then due to a Systems Issue the Exchange would not accept the resulting execution of the order (but rather transmitted a cancellation to the Member instead), an error position would result. Another example might be where a Systems Issue experienced by the Exchange automatically changed the number of shares associated with all orders from one or more Members, or all orders in one or more symbols (in either case resulting in overfills), or changed the symbol on one or more orders (resulting in executions in the wrong stocks), where

¹⁰ See, e.g., Nasdaq Rule 4627 (stating that all members must honor trades); BATS Rule 11.15(b); and NSX Rule 11.17(b) (both stating that transactions are locked-in and automatically processed for clearance and settlement).

such orders were routed by DE Route to a Trading Center for execution.¹¹

Assignment Methodology

Regardless of how an error position arose, DE Route would not typically learn about an error position until the next business day following the trade date, usually (but not exclusively) during the clearing process when a Trading Center has submitted to DTCC a transaction for clearance and settlement of which DE Route had not received an execution confirmation. Nonetheless, if DE Route reasonably determines that it has accurate and sufficient information, and a sufficient amount of time, it will assign the full amount of the resulting error position to one or more Members. For example, if Member A placed an order to buy 100 shares of symbol XYZ, and a Systems Issue caused DE Route to route an order for the wrong number of shares (e.g., 1000 shares), or route an order for the correct number of shares but in the wrong symbol (e.g., symbol XYY instead of XYZ), then, in either situation, DE Route would assign to Member A the full amount of the resulting error position (in the above examples, 1000 shares of XYZ, of which 900 shares would be the error position, or 100 shares of XYY, respectively). Under these circumstances, because the error position would have been caused by an Exchange or DE Route's Systems Issue, Member A would be permitted to submit a claim for reimbursement pursuant to EDGX Rule 11.12 to the extent that Member A incurred a loss after trading out of the error position.

The foregoing assignment methodology is designed to ensure that an error position is

¹¹ This discussion of potential scenarios that could lead to an error position is not intended to be an exhaustive list of all scenarios, but rather is just illustrative. The Exchange cannot anticipate every scenario, but does acknowledge that the types of error positions that might warrant use by DE Route of an error account would be limited to those arising from Systems Issues, as defined herein, which resulted in erroneous executions occurring on one or more Trading Centers.

assigned to Members in a non-discriminatory manner. Thus, if DE Route reasonably concludes that it is unable to trace each erroneous execution comprising an error position back to one or more Members' orders, then DE Route will assume the entire amount of the error position in the error account. Moreover, if DE Route reasonably concludes, due to the number of erroneous executions and/or the number of Members potentially impacted, that it would not be able to trace each erroneous execution comprising an error position back to such Members in a timely manner (which will be defined to mean by the first business day following the trade date on which the error position was established, or "T+1"), then DE Route will assume the entire amount of the error position in the error account. When an error position is acquired into DE Route's error account, it will then be liquidated as soon as practicable pursuant to proposed paragraph (a)(7) of Rule 2.11.

Proposed Changes to Exchange Rule 2.11

The Exchange proposes to amend EDGX Rule 2.11 to amend subparagraph (a)(4) and add new subparagraphs (a)(6) and (a)(7) to address the cancellation of orders due to Systems Issues and the use of an error account by DE Route, respectively.

Specifically, under proposed subparagraph (a)(6), the Exchange or DE Route would be expressly authorized to cancel orders as may be necessary to maintain fair and orderly markets if a Systems Issue occurred at the Exchange, DE Route or a Trading Center.¹² The Exchange or DE Route would be required to provide notice of the cancellation to affected Members as soon as practicable.

¹² Such a situation may not cause the Exchange to declare self-help against the Trading Center pursuant to Rule 611 of Regulation NMS under the Act. If the Exchange or DE Route determines to cancel orders routed to a Trading Center under proposed subparagraph (a)(6), but does not declare self-help against that Trading Center, the Exchange would continue to be subject to the order protection requirements of Rule 611 with respect to that Trading Center.

Under amended subparagraph (a)(4) and new subparagraph (a)(7), DE Route would be authorized, when providing routing services to the Exchange, to maintain an error account for the purpose of liquidating an error position acquired as a result of Systems Issues experienced either by DE Route itself, the Exchange or at a Trading Center, as described above. The rule amendments provide that DE Route would only assume an error position in the error account under documented circumstances when the error position could not fairly and practicably be assigned to one or more Members.

With proposed new subparagraph (a)(7) of Rule 2.11, the Exchange is proposing that DE Route would consider the following factors in determining whether the entire amount of an error position can be fairly and practicably assigned to one or more Members: (i) whether DE Route has accurate and sufficient information to trace each erroneous execution comprising an error position back to one or more Members' orders; and (ii) whether DE Route is able to review available information in order to assign the entire amount of an error position to all affected Members by the first business day following the trade date on which the error position was created (considering, among other factors, the size of the error position and the total number of Members potentially impacted). If as a result of the foregoing, DE Route reasonably concludes that the entire amount of an error position can be assigned to one or more Members in a timely and non-discriminatory manner, the entire amount of the error position will accordingly be assigned to such Members.¹³ An example of this might be where a Systems Issue of limited scope or duration occurred at a Trading Center, and the resulting trades submitted for clearance and settlement by such Trading Center to DTCC, coupled with the number of Member orders transmitted during that same time period or possessing similar, traceable characteristics, are

¹³ See examples listed under the section entitled "Assignment Methodology", supra.

adequately manageable so as to allow a sufficient amount of time to match the error position with Members' orders in a non-discriminatory fashion.

There may be scenarios, however, in which the entire amount of a particular error position resulting from a Systems Issue cannot be assigned to Members, or cannot be assigned to Members in a non-discriminatory manner. For example, in the event that there is insufficient and/or inaccurate information, or the routed order that led to an erroneous execution could not be attributed to a Member's order, then DE Route would not be able to trace erroneous executions back to a Member's order. Also, if the information available would enable tracing of some, but not all, of the erroneous executions comprising an error position to Members, then the Exchange believes that assigning only a portion of an error position to Members might unfairly discriminate against those Members. In these circumstances, therefore, DE Route may reasonably conclude, pursuant to the factors set forth in proposed Rule 2.11(a)(7), that it cannot assign the entire amount of an error position to one or more Members, or cannot assign it in a non-discriminatory manner, and must instead acquire the entire amount of the error position into the error account.

There may also be scenarios in which the entire amount of a particular error position resulting from a Systems Issue cannot practicably be assigned to Members in a timely manner. For example, the number of erroneous executions comprising an error position, and/or the number of Members potentially impacted, could be such that the research necessary to trace all of the erroneous executions comprising the error position back to particular Members' orders could reasonably be expected to extend beyond T+1. The Exchange believes that assigning an error position to a Member beyond T+1 significantly increases the potential for disruptions in the

normal clearance and settlement process,¹⁴ and also could result in adverse regulatory consequences for affected Members (e.g., their compliance with Rule 15c3-1 under the Act). In these circumstances, therefore, DE Route may reasonably conclude, pursuant to the factors set forth in proposed Rule 2.11(a)(7), that it is not practicable to assign the entire amount of an error position to one or more Members by T+1, and must instead acquire the entire amount of the error position into the error account.

DE Route would be required to document the factors considered in determining to assume an error position in the error account. Similarly, if DE Route determined that an error position could be assigned to a particular Member in a timely fashion, then DE Route would be required to document the rationale for the assignment to that Member. The assignment of any error position to any one or more Members would be required to be done in a non-discriminatory fashion; this includes, for example, that the entire amount of an error position must be assigned to all Members to which such position could reasonably be attributed. If time would not permit a full analysis of all Members to which a position could be attributed, then DE Route would not assign any portion of the error position to Members, but would rather have to assume the error position in its error account. Documentation reflecting assignment of an error position to one or more Members shall reflect such methodology.

Proposed subparagraph (a)(7) would further describe the manner in which DE Route would liquidate an error position from the error account. When, as and if DE Route determined to book an error position to its error account, DE Route would be required to liquidate such error position as soon as practicable in a manner that would effectively confer investment discretion

¹⁴ Specifically, the Exchange believes that the likelihood of erroneous executions failing to settle within the normal clearance and settlement cycle would increase the closer in time to the settlement date that the error position was assigned to a Member.

over the error position to a third-party broker-dealer. Specifically, DE Route would be required to: (i) provide complete time and price discretion to the third-party broker-dealer in the liquidation of the error position, including that it would not be permitted to exercise any influence or control over the timing or methods of trading; and (ii) establish and implement written policies and procedures in accordance with paragraph (a)(7) that are reasonably designed to restrict the flow of any confidential and proprietary information associated with the liquidation of an error position between the Exchange and DE Route, on one hand, and the third-party broker-dealer, on the other.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the objectives of Section 6 of the Act,¹⁵ in general, and furthers the objectives of Section 6(b)(5),¹⁶ in particular, as it is 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, 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, and is not designed to permit unfair discrimination between customers, brokers or dealers. The Exchange believes that this proposal is in keeping with those principles since the Exchange's and DE Route's ability to cancel orders as a result of a Systems Issue and to maintain an error account facilitates the smooth and efficient operations of the market. Specifically, the Exchange believes that allowing the Exchange or DE Route to cancel orders as a result of a Systems Issue would

¹⁵ 15 U.S.C. 78f.

¹⁶ 15 U.S.C. 78f(b)(5).

allow the Exchange to maintain fair and orderly markets. Moreover, the Exchange believes that allowing DE Route to assume a bona fide error position in an error account, and to liquidate the error position subject to the conditions set forth in the proposed amendments to Rule 2.11, would be the least disruptive means to correct the error position, except where it is practicable for DE Route to assign an error position to one or more Members of the Exchange. The proposed amendments are designed to ensure full trade certainty for market participants and avoid disrupting the clearance and settlement process. The proposed amendments are also designed to provide a consistent methodology for handling an error position in a manner that does not discriminate among Members. Finally, the proposed amendments are also consistent with Section 6 insofar as they would require DE Route to establish controls that are reasonably designed to restrict the flow of any confidential information associated with the liquidation of an error position between the Exchange and DE Route, on one hand, and the third-party broker-dealer, on the other.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds

such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve or disapprove such proposed rule change; or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

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
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-EDGX-2012-08 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-2012-08. 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, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the 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-EDGX-2012-08 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁷

Elizabeth M. Murphy
Secretary

¹⁷ 17 CFR 200.30-3(a)(12).