

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-69378; File No. SR-EDGX-2013-13)

April 15, 2013

Self-Regulatory Organizations; EDGX Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Footnote 4 of the Exchange's Fee Schedule Regarding Retail Orders

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 April 5, 2013, EDGX Exchange, Inc. (the "Exchange" or "EDGX") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II, which items have been 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 [sic] Footnote 4 of the Exchange's fee schedule regarding Retail Orders. All of the changes described herein are applicable to EDGX Members. The text of the proposed rule change is available on the Exchange's Internet 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 self-regulatory organization 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

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

<sup>2</sup> 17 CFR 240.19b-4.

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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

In SR-EDGX-2012-47,<sup>3</sup> the Exchange introduced new Flags ZA (Retail Order, adds liquidity) and ZR (Retail Order, removes liquidity) and appended to each flag Footnote 4 to the Exchange’s fee schedule. Footnote 4 defined a “Retail Order,” provided an attestation requirement for Members<sup>4</sup> to comply with when sending Retail Orders to the Exchange, and noted that Members may designate orders as Retail Orders on an order-by-order basis. In SR-EDGX-2012-48,<sup>5</sup> the Exchange subsequently expanded Members’ ability to send the Exchange Retail Orders by designating certain of their FIX ports at the Exchange as “Retail Order Ports.” The attestation requirement, as described in SR-EDGX-2012-47,<sup>6</sup> will continue to apply to all Members who submit Retail Orders, whether on an order-by-order basis or via Retail Order Ports.

Proposed Amendment to Definition of “Retail Order”

Footnote 4 on the Exchange’s fee schedule currently defines a Retail Order as: “(i) an agency order that originates from a natural person; (ii) is submitted to EDGX by a Member, provided that no change is made to the terms of the order; and (iii) the order does not originate

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<sup>3</sup> See Securities Exchange Act Release No. 68310 (November 28, 2012), 77 FR 71860 (December 4, 2012) (SR-EDGX-2012-47).

<sup>4</sup> As defined in Exchange Rule 1.5(n).

<sup>5</sup> See Securities Exchange Act Release No. 68554 (December 31, 2012), 78 FR 966 (January 7, 2013) (SR-EDGX-2012-48).

<sup>6</sup> See Securities Exchange Act Release No. 68310 (November 28, 2012), 77 FR 71860 (December 4, 2012) (SR-EDGX-2012-47).

from a trading algorithm or any other computerized methodology.”<sup>7</sup> The Exchange believes that its definition of a “Retail Order” is unnecessarily restrictive compared to that of other exchanges in that the Exchange does not include “riskless principal orders” in its definition.<sup>8</sup> The Exchange believes that its comparatively narrow definition may create confusion among the Exchange’s Members, preventing Members from submitting Retail Orders and benefiting from the enhanced rebate and transparency of such orders. In addition, the Exchange believes that the restrictiveness of the Exchange’s definition may inadvertently put the Exchange at a competitive disadvantage in relation to other exchanges that provide a less restrictive definition of a “Retail Order.”

Accordingly, the Exchange proposes to amend the definition of a “Retail Order” in Footnote 4 to add riskless principal orders to the types of orders that may qualify as Retail Orders.<sup>9</sup> The Exchange proposes to amend Footnote 4 to state “[w]here a Retail Order is defined as (i) an agency order or riskless principal order that satisfies the criteria of FINRA Rule 5320.03 that originates from a natural person; (ii) is submitted to EDGX by a Member, provided that no change is made to the terms of the order; and (iii) the order does not originate from a trading algorithm or any other computerized methodology.” (emphasis added).<sup>10</sup>

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<sup>7</sup> See EDGX Fee Schedule, <http://www.directedge.com/Membership/FeeSchedule/EDGXFeeSchedule.aspx>.

<sup>8</sup> The Exchange notes that other market centers include “riskless principal orders” as part of their definitions of “Retail Orders.” See, e.g., Securities Exchange Act Release No. 68937 (February 15, 2013), 78 FR 12397 (February 22, 2013) (SR-NASDAQ-2012-129); Securities Exchange Act Release No. 69103 (March 11, 2013), 78 FR 16547 (March 15, 2013) (SR-NYSE-2013-20); Securities Exchange Release No. 69104 (March 11, 2013), 78 FR 16556 (March 15, 2013) (SR-NYSEMKT-2013-22).

<sup>9</sup> The Exchange notes that in order to qualify as a “Retail Order,” a “riskless principal” order must satisfy the criteria set forth in FINRA Rule 5320.03.

<sup>10</sup> The Exchange notes that it will amend its attestation form for Members designating Retail Orders to conform with these new requirements.

The Exchange believes that, for purposes of determining whether an order should qualify as a Retail Order, there is no difference between a riskless principal order that meets the requirements of FINRA Rule 5320.03 and an agency order. A riskless principal transaction is a transaction in which a Member, after having received an order to buy (sell) a security, purchases (sells) the security as principal and, contemporaneously, satisfies the original order by selling (buying) as principal at the same price. Generally, a riskless principal transaction involves two orders, the execution of one being dependent upon the receipt or execution of the other; thus, there is no “risk” in the interdependent transactions when completed. Unlike a riskless principal transaction, an agency order is entered directly in the System<sup>11</sup> by a Member on behalf of a customer. Ultimately, however, the results of a riskless principal transaction and an agency order are the same: the customer receives an execution while the involved Member acts as an intermediary to effect the transaction.<sup>12</sup>

The Exchange believes that the requirement that the entry of such riskless principal orders satisfy FINRA Rule 5320.03 provides sufficient protection against Members submitting orders for their own account to the Exchange. A Member entering a riskless principal transaction will have to, contemporaneously with the execution of the customer’s order, submit a report identifying the trade as riskless principal to FINRA. Additionally, the Member will need to have written policies and procedures to ensure that riskless principal transactions comply with applicable FINRA rules. The policies and procedures, at a minimum, must require that the customer order be received prior to the offsetting principal transaction, and that the offsetting principal transaction is at the same price as the customer order exclusive of any markup or

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<sup>11</sup> As defined in Exchange Rule 1.5(cc).

<sup>12</sup> A principal transaction differs from both a riskless principal transaction and an agency order in that it is an order for the principal account of the entering Member.

markdown, commission equivalent, or other fee, and is allocated to a riskless principal or customer account in a consistent manner and within 60 seconds of execution. Additionally, the Member must have supervisory systems in place that produce records that enable the Member and FINRA to reconstruct accurately, readily, and in a time-sequenced manner all Retail Orders that are entered on a riskless principal basis.

The Exchange believes that the Member must also ensure that non-Retail Orders from customers are not included with the Retail Orders as part of a riskless principal transaction. The above requirements ensure that despite the procedural differences between the execution of a riskless principal transaction and an agency order, the only difference will be the procedure in which the transactions are effected and not the result.

The Exchange further believes that clarifying that riskless principal orders that meet the requirements of FINRA Rule 5320.03 are able to be submitted as Retail Orders on the same basis as agency orders will enable Members, and in turn, their retail customers, to benefit from the enhanced rebate (Flag ZA) and transparency offered by the Exchange.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Securities Exchange Act of 1934 (the "Act"),<sup>13</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>14</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

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<sup>13</sup> 15 U.S.C. 78f.

<sup>14</sup> 15 U.S.C. 78f(b)(5).

The Exchange believes that the proposed rule change promotes just and equitable principles of trade because it will ensure that riskless principal orders that meet the requirements of FINRA Rule 5320.03 will have the same opportunity to be submitted as Retail Orders as agency orders. As discussed above, there is no functional distinction for purposes of Retail Orders between an order entered by a Member on an agency basis and one entered on a riskless principal basis. The Exchange believes that the proposed change would tend to reduce any potential discrimination between similarly situated customers or brokers by ensuring that the ability of retail customers to benefit from the use of Retail Orders does not depend on a distinction in capacity that is not meaningful for purposes of submitting Retail Orders. As a result of the change, a retail customer would be able to benefit from the rebate (Flag ZA) for utilizing Retail Orders without regards to whether the Member enters the order on a riskless principal or agency basis.

The Exchange believes that the proposed rule change will remove impediments to and perfect the mechanism of a free and open market and a national market system because it will clarify that riskless principal orders that meet the requirements of FINRA Rule 5320.03 are eligible to be submitted as Retail Orders on the same basis as agency orders. By allowing all orders that are functionally equivalent to agency orders to be submitted as Retail Orders, the proposed change would potentially stimulate further competition for retail order flow.

The Exchange believes that the proposed change would protect investors and the public interest by expanding the access of Members to the rebate for Flag ZA and the transparency offered by the Exchange as well as the access of the public to an exchange sponsored alternative to broker-operated internalization venues. In this regard, the Exchange believes that maintaining or increasing the proportion of Retail Orders in exchange-listed securities that are executed on a

registered national securities exchange (rather than relying on certain available off-exchange execution methods) would contribute to investors' confidence in the fairness of their transactions and would benefit all investors by deepening the Exchange's liquidity pool, supporting the quality of price discovery, promoting market transparency and improving investor protection.

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.

The Exchange believes that the proposed amendment to allow Members to submit Retail Orders on a riskless principal basis will not burden intramarket competition because the ability to submit Retail Orders on a riskless principal basis would be open to all Members that wish to send Retail Orders to the Exchange.

The Exchange believes that the proposed amendment, by increasing the eligible orders that qualify as Retail Orders, would reduce burdens on competition around retail executions such that Members would receive better rebates than they currently do on the Exchange and potentially through bilateral internalization arrangements. The Exchange believes that the transparency and competitiveness of designating Retail Orders on an exchange market would result in better rebates for Members, and ultimately benefit retail investors by expanding the capabilities of Exchanges to encompass practices currently allowed on non-Exchange venues.

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

The Exchange has neither solicited nor received written comments on the proposed rule change.

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

Because the foregoing proposed rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) by its terms does not become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>15</sup> and Rule 19b-4(f)(6) thereunder.<sup>16</sup>

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative for 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii) permits the Commission to 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 the proposal may become operative immediately upon filing. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver would allow the Exchange to add riskless principal orders to the types of orders that may qualify as Retail Orders for purposes of the Exchange's fee schedule.<sup>17</sup> The Commission also notes that several other market centers have recently added riskless

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

<sup>16</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to provide the Commission with 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 Commission has waived this requirement in this case.

<sup>17</sup> For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

principal orders to its definition of retail orders.<sup>18</sup> Accordingly, the Commission hereby grants the Exchange's request and designates the proposal operative upon filing.

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
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-EDGX-2013-13 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-2013-13. 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>18</sup> See Securities Exchange Act Release No. 68937 (February 15, 2013), 78 FR 12397 (February 22, 2013) (SR-NASDAQ-2012-129); Securities Exchange Act Release No. 69103 (March 11, 2013), 78 FR 16547 (March 15, 2013) (SR-NYSE-2013-20); Securities Exchange Release No. 69104 (March 11, 2013), 78 FR 16556 (March 15, 2013) (SR-NYSEMKT-2013-22).

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-2013-13 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.<sup>19</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>19</sup> 17 CFR 200.30-3(a)(12).