

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-78193; File No. SR-BatsBZX-2016-28]

### Self-Regulatory Organizations; Bats BZX Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Remove Interpretation and Policy .01 From Rule 11.13, Order Execution and Routing

June 29, 2016.

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 June 23, 2016, Bats BZX Exchange, Inc. (the “Exchange” or “BZX”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange has designated this proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders it effective upon filing with the Commission. 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 filed a proposal to remove Interpretation & Policy .01 from Exchange Rule 11.13, as further described below.

The text of the proposed rule change is available at the Exchange’s Web site at [www.batstrading.com](http://www.batstrading.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 IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts of such statements.

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

##### 1. Purpose

##### Introduction

In 2011, the Exchange identified an inefficiency in its handling of certain non-displayed orders resting on the Exchange at a price equal to the Exchange’s best displayed orders on the opposite side of the market (“Locking Price”) (the non-displayed orders at the Locking Price, “Non-Displayed Orders”). Similarly, the Exchange identified an inefficiency in its handling of certain displayed orders that were ranked at the Locking Price and displayed at a permissible price one minimum price variation away from the Locking Price (such orders “Resting Order Subject to NMS Price Sliding”). In order to avoid an apparent issue under its then-existing priority rule, the Exchange was rejecting incoming orders that were otherwise marketable against the Non-Displayed Orders or the Resting Orders Subject to NMS Price Sliding. In order to optimize available liquidity for incoming orders and to provide price improvement for market participants, the Exchange proposed in May of 2011 to execute a resting Non-Displayed Order or Resting Order Subject to NMS Price Sliding at one-half minimum price variation less than the Locking Price in the case of a bid and one-half minimum price variation more than the Locking Price in the case of an offer.<sup>5</sup>

To ease concerns that these new order-handling procedures could be abused solely for the purpose of obtaining executions at one-half minimum price variations—although there was no evidence to suggest this might occur—the Exchange included Interpretation and Policy .01 to Rule 11.13 stating:

The Exchange will consider it inconsistent with just and equitable principles of trade to engage in a pattern or practice of using Non-Displayed Orders or orders subject to price sliding solely for the purpose of executing such orders at one-half minimum price variation from the locking price. Evidence of such behavior may include, but is not limited to, a User’s pattern of entering orders at a price that would lock or be ranked at the price of a displayed quotation and cancelling orders when they no longer lock the displayed quotation.

<sup>5</sup> See Securities Exchange Act Release No. 64754 (May 12, 2011), 76 FR 28830 (May 18, 2011) (SR-BATS-2011-015) (“2011 Proposal”). The reference to the most “aggressive” price, as used in that filing, means for bids the highest price the User is willing to pay, and for offers the lowest price at which the User is willing to sell.

The Exchange also stated in the 2011 Proposal that it would conduct surveillance to monitor for such potential abuse.<sup>6</sup>

The Commission approved the 2011 Proposal,<sup>7</sup> and the Exchange has conducted nearly five years of surveillance as it promised in the 2011 Proposal. After this lengthy period of surveillance, the Exchange has determined that there is no evidence that market participants attempt to use the Exchange’s order handling procedures in Rule 11.13 solely to obtain executions at one-half minimum price variations. Further, the Exchange has found no way in which a market participant could abuse these order handling procedures. It is the Exchange’s position, therefore, that Interpretation and Policy .01 and its corollary surveillance is now unnecessary. The Exchange proposes to remove the unnecessary Interpretation and Policy and to discontinue the corollary surveillance.

##### Background

Prior to the implementation of the 2011 Proposal, consistent with the Exchange’s rule regarding priority of orders, Rule 11.12, in order to avoid an apparent priority issue under the Exchange’s rules Non-Displayed Orders and Resting Orders Subject to NMS Price Sliding were not executed by the Exchange pursuant to Rule 11.13 when such orders would be executed at a Locking Price. Specifically, if incoming orders were allowed to execute against the resting Non-Displayed Order or the Resting Order Subject to NMS Price Sliding at the Locking Price, such orders would have received a perceived priority advantage over a resting, displayed contra-side order at the Locking Price; accordingly, such executions at the Locking Price were disallowed. As noted above, however, the Exchange proposed functionality to optimize available liquidity for incoming orders and to provide price improvement for market participants, which was subsequently approved and implemented by the Exchange.<sup>8</sup> Below is an example that illustrates how the Exchange has handled such orders following the implementation of functionality described in the 2011 Proposal.

<sup>6</sup> See 2011 Proposal, *supra* note 5, at 28833.

<sup>7</sup> See Securities Exchange Act Release No. 64754 (June 27, 2011), 76 FR 38712 (July 1, 2011) (SR-BATS-2011-015) (Order Approving a Proposed Rule Change To Amend BATS Rule 11.9, Entitled “Orders and Modifiers” and BATS Rule 11.13, Entitled “Order Execution”) (“2011 Approval”).

<sup>8</sup> See *id.*

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

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

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

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

Assume the Exchange has a posted and displayed bid to buy 100 shares of a security priced at \$10.10 per share, a resting Non-Displayed Order bid to buy 100 shares of a security priced at \$10.11 per share, and a posted and displayed offer to sell 100 shares also at \$10.11 per share. Assume the NBBO is also \$10.10 by \$10.11. The Exchange's order book ("BZX Book") in this situation can be depicted as follows, with "ND" identifying the Non-Displayed Order:

	Bid		Offer
Bats:	\$10.11 (ND) \$10.10	X	\$10.11

If an incoming offer to sell 100 shares at \$10.10 is entered into the BZX Book, the resting Non-Displayed Order at the locking price will be executed at \$10.105 per share, thus providing the resting Non-Displayed bid a half-penny of price improvement from its limit price of \$10.11 and the incoming offer a half-penny of price improvement from its limit price of \$10.10. The result would be the same for an incoming market order to sell or any other incoming limit order offer priced at \$10.10 or below, which would execute against the Non-Displayed bid at a price of \$10.105 per share. An offer at the full price of the resting and displayed \$10.11 offer would not execute against the resting Non-Displayed bid, but would instead either cancel or post to the BZX Book behind the original \$10.11 offer in priority. As described above, the Exchange has adopted similar functionality with respect to Resting Orders Subject to NMS Price Sliding.

#### Interpretation and Policy .01 to Rule 11.13

In proposing the 2011 Proposal, there was concern from Commission staff that market participants may attempt to abuse the rule solely to obtain executions at one-half minimum price variations. To assuage the concern, the Exchange included Interpretation and Policy .01 to Rule 11.13 to state explicitly that the Exchange will consider it inconsistent with just and equitable principles of trade to engage in a pattern or practice of using Non-Displayed Orders or Resting Orders Subject to NMS Price Sliding solely for the purpose of executing such orders at one-half minimum price variations from the locking price. The Exchange further explained that evidence of such behavior may include, but is not limited to, a User's pattern of entering orders at a price that would lock or be ranked at the price of a displayed quotation and cancelling orders when they no longer

lock the displayed quotation. The Exchange stated in the 2011 Proposal it would "conduct surveillance to ensure that Users are not intentionally seeking to create an internally locked Book for the purpose of obtaining an execution at one-half minimum price variation."<sup>9</sup> The Exchange notes that when proposed the Exchange believed the functionality was a solution to a specific situation that was a natural consequence of the Exchange's order handling procedures, particularly due to offering Users the ability to enter orders that instruct the Exchange not to remove liquidity (*i.e.*, "Post Only Orders") and to enter orders with non-displayed prices.<sup>10</sup> The Exchange still believes this to be the case and thus, as further described below, seeks to eliminate surveillance focused on orders and System functionality that are simply behaving as the Exchange intends them to behave.

In approving the rule change, the Staff noted the proposed Interpretation and Policy .01:

The Exchange also proposes adding Interpretation and Policy .01 to BATS Rule 11.13 to state that the Exchange will consider it inconsistent with just and equitable principles of trade to engage in a pattern or practice of using Non-Displayed Orders or orders subject to price sliding solely for the purpose of executing such orders at one-half minimum price variation from the locking price. Evidence of such behavior may include, but is not limited to, a User's pattern of entering orders at a price that would lock or be ranked at the price of a displayed quotation and cancelling orders when they no longer lock the displayed quotation. The Exchange has also stated that it will conduct surveillance to ensure that users are not intentionally seeking to create an internally locked book for the purpose of obtaining an execution at a one-half minimum price variation.<sup>11</sup>

The Commission stated in its approval order that it "believes that any potential abuses are mitigated by the Exchange's addition of Interpretation and Policy .01 to BATS Rule 11.13 and its commitment to monitor relevant trading on its market."<sup>12</sup>

#### Proposal To Remove Interpretation and Policy .01 to Rule 11.13

The Exchange designed and implemented a surveillance program to monitor for abuse of the order handling procedures implemented by the 2011 Proposal and has conducted the surveillance for nearly five years. The Exchange has found over this period no evidence to suggest that market

participants intentionally seek to create an internally locked book solely for the purpose of obtaining an execution at one-half minimum price variation. The evidence has shown that half-penny executions appear to be the natural result of order interactions on the Exchange. Further, since the change, market participants have received price improvement on both sides of a trade when that trade would have otherwise been prevented from occurring under the Exchange's prior functionality. The Exchange, therefore, no longer believes Interpretation and Policy .01 is necessary or appropriate.

The purpose of Interpretation and Policy .01 and the associated surveillance was to ensure that market participants would not find a way to abuse the new order handling procedures by engaging in a pattern or practice of entering non-displayed locking orders solely for the purpose of obtaining an execution at one-half minimum price variation. Since the Exchange has determined there is no evidence that such abuse has occurred the Exchange believes that Interpretation and Policy and corollary surveillance have served their purpose and are no longer necessary. The Exchange believes that its regulatory program would be better served by the removal of Interpretation and Policy .01 so that the Exchange staff may retire the surveillance and focus its regulatory efforts on activity that it has identified as having an impact on the safety and quality of its market.

Finally, Bats EDGX Exchange Inc. ("EDGX") and Bats EDGA Exchange Inc. ("EDGA") have substantively identical order handling functionality, but neither have the Interpretation and Policy this proposal seeks to remove. The Exchange, therefore, believes that the Interpretation and Policy is unnecessary and the Exchange proposes to remove it from Rule 11.13. Although the Exchange is proposing to remove Interpretation and Policy .01 from Rule 11.13, the Exchange notes that all trading activity on the Exchange, including orders entered and handled and executions resulting from the order handling procedures implemented by the 2011 Proposal, is subject to the Exchange's overall surveillance program, which monitors for potential violations of the federal securities laws and the regulations thereunder as well as Exchange Rules.

#### 2. Statutory Basis

The rule change proposed in this submission is consistent with the requirements of the Act and the rules and regulations thereunder that are

<sup>9</sup> See 2011 Proposal, *supra* note 5, at 28833.

<sup>10</sup> See *id.*

<sup>11</sup> See 2011 Approval, *supra* note 7 at 38713.

<sup>12</sup> *Id.*

applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.<sup>13</sup> Specifically, the proposed change is consistent with Section 6(b)(5) of the Act,<sup>14</sup> because 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 facilitating transactions in securities, and to remove impediments to, and perfect the mechanism of, a free and open market and a national market system. The proposed change to remove Interpretation and Policy .01 from Rule 11.13 will permit the Exchange to focus its regulatory efforts on conduct that more likely violates principles of just and equitable trade rather than dedicating regulatory staff and efforts on a topic which the Exchange has found no evidence of its existence. Since 2011, the Exchange has dedicated resources to operate regulatory surveillance and investigate potential abuse of the Exchange's functionality and has found that there is no evidence of abuse of the relevant order handling procedures solely for the purpose of obtaining one-half minimum price variations. The Exchange believes the proposal will promote just and equitable principles of trade and will help prevent fraudulent and manipulative acts by focusing regulatory efforts on activity that the Exchange has identified as having an impact on the safety and quality of its market rather than the hypothetical concern that Interpretation and Policy .01 was implemented to monitor.

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

The Exchange does not believe that the proposed rule changes will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change simply removes an interpretation and policy that the Exchange does not believe is necessary, as described above, and should have no effect on competition.

#### *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 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, it 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>

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. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule change should be approved or 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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-BatsBZX-2016-28 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 No. SR-BatsBZX-2016-28. This file number should be included on the subject line if email 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 Web site (<http://www.sec.gov/>

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

<sup>16</sup> 17 CFR 240.19b-4(f)(6). As required under Rule 19b-4(f)(6)(iii), the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and the 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.

*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 Web site 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 No. SR-BatsBZX-2016-28, and should be submitted on or before July 27, 2016.

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

**Robert W. Errett,**

*Deputy Secretary.*

[FR Doc. 2016-15916 Filed 7-5-16; 8:45 am]

**BILLING CODE 8011-01-P**

## **SECURITIES AND EXCHANGE COMMISSION**

### **Sunshine Act Meeting**

Notice is hereby given, pursuant to the provisions of the Government in the Sunshine Act, Public Law 94-409, that the Securities and Exchange Commission will hold a Closed Meeting on Thursday, July 7, 2016 at 2:00 p.m.

Commissioners, Counsel to the Commissioners, the Secretary to the Commission, and recording secretaries will attend the Closed Meeting. Certain staff members who have an interest in the matters also may be present.

The General Counsel of the Commission, or her designee, has certified that, in her opinion, one or more of the exemptions set forth in 5 U.S.C. 552b(c)(3), (5), (7), 9(B) and (10) and 17 CFR 200.402(a)(3), (5), (7), 9(ii) and (10), permit consideration of the scheduled matter at the Closed Meeting.

Chair White, as duty officer, voted to consider the items listed for the Closed Meeting in closed session.

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

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

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