

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-73742; File No. SR-BYX-2014-035)

December 4, 2014

Self-Regulatory Organizations; BATS Y-Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend Rule 14.1(c)(5) of BATS Y-Exchange, Inc., to Remove the Restriction Prohibiting Market Makers in UTP Derivative Securities from Acting or Registering as a Market Maker in Any Reference Asset of that UTP Derivative Security or Any Derivative Instrument Based on Such Reference Asset

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 November 21, 2014, BATS Y-Exchange, Inc. (“Exchange” or “BYX”) 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)(iii) 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 amend Rule 14.1(c)(5) to harmonize its restrictions on Market Makers<sup>5</sup> in UTP Derivative Securities<sup>6</sup> with NYSE Arca, Inc. (“NYSE Arca”) Rule

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

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

<sup>5</sup> The term “Market Maker” is defined as “a Member that acts as a Market Maker pursuant to Chapter XI.” See Exchange Rule 1.5(l).

5.1(a)(2)(v)<sup>7</sup> and the Nasdaq Stock Market LLC (“Nasdaq”) Rule 4630(e).<sup>8</sup>

The text of the proposed rule change is available at the Exchange’s website at <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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend Rule 14.1(c)(5) to harmonize its restrictions on Market

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<sup>6</sup> The term “UTP Derivative Security” is defined as “[a]ny UTP Security that is a ‘new derivative securities product’ as defined in Rule 19b-4(e) under the Exchange Act . . . and traded pursuant to Rule 19b-4(e) under the Exchange Act.” See Exchange Rule 14.1(c).

<sup>7</sup> See Securities Exchange Act Release No. 67066 (May 29, 2012), 77 FR 33010 (June 4, 2012) (SR-NYSEArca-2012-46) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change Regarding the Extension of Unlisted Trading Privileges to New Derivative Securities Products That Are Listed on Another Exchange and to Make Other Conforming and Technical Amendments). The Commission also waived the 30-day operative delay for SR-NYSEArca-2012-46 under Rule 19b-4(f)(6) of the Act. *Id.*

<sup>8</sup> See Securities Exchange Act Release No. 69858 (June 25, 2013), 78 FR 39432 (July 1, 2013) (SR-Nasdaq-2013-085) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change [sic] Rule 4630 to Remove a Restriction on a Member Acting as a Registered Market Maker in a Commodity-Related Security).

Makers in UTP Derivative Securities with NYSE Arca Rule 5.1(a)(2)(v)<sup>9</sup> and Nasdaq Rule 4630(e).<sup>10</sup> The purpose of the proposed rule change is to permit a Member acting as a registered Market Maker in a UTP Derivative Security on the Exchange the flexibility to act or register as a market maker in any Reference Asset<sup>11</sup> that a UTP Derivative Security derives its value from consistent with Commission and Exchange Rules.

Exchange Rule 14.1(c)(5) prohibits a Market Maker in a UTP Derivative Security from acting or registering as a market maker on another exchange in any Reference Asset of that UTP Derivative Security, or any derivative instrument based on a Reference Asset of that UTP Derivative Security. NYSE Arca Rule 5.1(a)(2)(v) and Nasdaq Rule 4630(e) recently amended their respective rules to permit market makers to trade in securities underlying the derivative security so long as that market maker discloses to NYSE Arca or Nasdaq all accounts within which it trades the underlying securities.<sup>12</sup> As amended, Exchange Rule 14.1(c)(5), would similarly remove this prohibition, which states that a Market Maker in a UTP Derivative Security is prohibited from acting or registering as a market maker on another exchange in any Related Instruments.

Similar to NYSE Arca Rule 5.1(a)(2)(v) and Nasdaq Rule 4630(e), amended Rule 14.1(c)(5) would require a Member acting as a registered Market Maker in a UTP Derivative Security to file with the Exchange, in a manner prescribed by the Exchange, and to keep a

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<sup>9</sup> See supra note 7.

<sup>10</sup> See supra note 8.

<sup>11</sup> A “Reference Asset” is defined as one or more currencies, or commodities, or derivatives based on one or more currencies, or commodities, or is based on a basket or index comprised of currencies or commodities that a UTP Derivative Security derives its value from. See Exchange Rule 14.1(c)(5).

<sup>12</sup> See supra notes 7 and 8.

current list identifying all accounts for trading the underlying physical asset or commodity, related futures or options on futures, or any other related derivatives (collectively with Reference Assets, “Related Instruments”), which the Member acting as registered Market Maker may have or over which it may exercise investment discretion. Rule 14.1(c)(5) would also prohibit a Member from acting as registered Market Maker in the UTP Derivative Security from trading in the underlying physical asset or commodity, related futures or options on futures, or any other related derivatives, in an account in which a Member acting as a registered Market Maker, directly or indirectly, controls trading activities, or has a direct interest in the profits or losses thereof, that has not been reported to the Exchange.

Exchange Rules<sup>13</sup> ensure that Market Makers in UTP Derivative Securities would continue to have in place reasonably designed policies and procedures to prevent the misuse of material non-public information with regard to also acting as a Market Maker in any Related Instruments.<sup>14</sup> In the context of approving a more flexible, principled-based approach to information barriers by NYSE Arca, the Commission stated that, “while information barriers are not specifically required under the proposal, a [firm’s] business model or business activities may dictate that an information barrier or a functional separation be part of the appropriate set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities law and regulations, and with applicable Exchange rules.”<sup>15</sup> Rule 14.1(c)(5)(D) will continue to prohibit Market Makers from using material non-public information in connection with trading a Related Instrument. Rule 14.1(c)(5)(C) will also

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<sup>13</sup> See Exchange Rules 5.5 and 14.1(c)(5)(D).

<sup>14</sup> 15 U.S.C. 78o(g).

<sup>15</sup> See Securities Exchange Act Release No. 60604 (September 1, 2009), 74 FR 46272 (September 8, 2009) (SR-NYSEArca-2009-78).

continue to require that, in addition to the existing obligations under Exchange rules regarding the production of books and records, a Market Maker shall, upon request by the Exchange, make available to the Exchange any books, records or other information pertaining to any Related Instrument trading account or to the account of any registered or non-registered employee affiliated with the Market Maker for which Related Instruments are traded. Lastly, under Exchange Rule 14.1(c)(6) the Exchange will enter into comprehensive surveillance sharing agreement with other markets that offer trading in Related Instruments to the same extent as the listing exchange's rules require the listing exchange to enter into a comprehensive surveillance sharing agreement with such markets. This amendment does not lessen the protection of Members from the risks associated with integrated market making and any possible misuse of non-public information.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>16</sup> and furthers the objectives of Section 6(b)(5) of the Act,<sup>17</sup> in that it is designed 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, and, in general, protect investors and the public interest. In addition, the Exchange believes that the proposed rule change is not designed to permit unfair discrimination between customers, issuers, brokers or dealers. The proposed rule change is substantially similar to the existing NYSE Arca Rule 5.1(a)(2)(v) and Nasdaq Rule 4630(e).<sup>18</sup> In addition, the Exchange believes that amending Exchange Rule 14.1(c)(5) to

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<sup>16</sup> 15 U.S.C. 78f(b).

<sup>17</sup> 15 U.S.C. 78f(b)(5).

<sup>18</sup> See supra notes 7 and 8.

permit a Member acting as a registered Market Maker in a UTP Derivative Security on the Exchange the flexibility to act or register as a market maker in any Reference Asset that a UTP Derivative Security derives its value from consistent with Commission and Exchange Rules will remove impediments to and perfect the mechanism of a free and open market by providing the same flexibility to the Exchange that is already available to NYSE Arca and Nasdaq regarding the market maker activities for derivative-related Securities. Additionally, Exchange Rule 14.1(c)(5), as amended, would continue to serve to prevent fraudulent and manipulative acts and practices, as well as to protect investors and the public interest from concerns that may be associated with integrated market making and any possible misuse of non-public information.

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

The proposed rule change would not impose any burden on competition. On the contrary, the Exchange believes that the proposal will promote competition because it is a competitive response to recently amended NYSE Arca and Nasdaq rules which permit market makers to trade in the reference assets or components underlying the derivative security on the same terms as that proposed by the Exchange.<sup>19</sup> Thus, the Exchange believes this proposed rule change is necessary to permit fair competition among national securities exchanges.

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.

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<sup>19</sup> See supra notes 7 and 8.

### 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 prior to 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, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>20</sup> and Rule 19b-4(f)(6)(iii) thereunder.<sup>21</sup>

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 waiver of the 30-day operative delay period is consistent with the protection of investors and the public interest. The Commission notes that the proposal would allow Market Makers in a UTP Derivative Security on the Exchange to act or register as a Market Maker in any Related Instruments. The Commission believes that proposal could allow the Exchange to attract more Market Makers to the Exchange, thereby potentially increasing liquidity in UTP Derivative Securities, provide more price competition, and enhance the markets for those securities. The Commission further notes that the proposal is similar to the rules of other national securities exchanges.<sup>22</sup> Therefore, the Commission designates the proposed rule change to be operative

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<sup>20</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>21</sup> 17 CFR 240.19b-4(f)(6)(iii). 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.

<sup>22</sup> See NYSE Arca Equities Rule 5.1(a)(2)(v) and Nasdaq Rule 4630(e).

upon filing.<sup>23</sup>

At any time within 60 days of the filing of such 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 under Section 19(b)(2)(B)<sup>24</sup> of the Act 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-BYX-2014-035 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-BYX-2014-035. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

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<sup>23</sup> For 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).

<sup>24</sup> 15 U.S.C. 78s(b)(2)(B).



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 such filing will also 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-BYX-2014-035 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>25</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>25</sup> 17 CFR 200.30-3(a)(12).