SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72445; File No. SR-EDGX-2014-05)

June 20, 2014

Self-Regulatory Organizations; EDGX Exchange, Inc.; Order Instituting Proceedings to
Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt a New Order
Type Called the Mid-Point Discretionary Order

I.   Introduction

On March 7, 2014, EDGX Exchange, Inc. ("Exchange" or "EDGX") filed with the

Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the

Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to

amend its rules to add a new order type called the Mid-Point Discretionary Order ("MDO") and

to reflect the priority of MDOs. The proposed rule change was published for comment in the

Federal Register on March 25, 2014.[3] On May 2, 2014, the Commission extended the time

period in which to either approve or disapprove the proposed rule change to June 23, 2014.[4] The

Commission received no comment letters on the proposed rule change. This order institutes

proceedings under Section 19(b)(2)(B) of the Act[5] to determine whether to approve or

disapprove the proposed rule change.

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[1]   15 U.S.C. 78s(b)(1).

[2]   17 CFR 240.19b-4.

[3]   See Securities Exchange Act Release No. 71747 (March 19, 2014), 79 FR 16401 (March
          25, 2014) ("Notice").

[4]   See Securities Exchange Act Release No. 72086 (May 2, 2014), 79 FR 26473 (May 8,
          2014).

[5]   15 U.S.C. 78s(b)(2)(B).

II.   Description of the Proposal

    A.   Proposed Mid-Point Discretionary Order

The Exchange proposes to add a new order type – called the Mid-Point Discretionary Order or MDO. An MDO would be a limit order to buy that is displayed and pegged to the National Best Bid ("NBB"), with discretion to execute at prices up to and including the mid-point of the NBBO,[6] and a limit order to sell that is displayed and pegged to the National Best Offer ("NBO"), with discretion to execute at prices down to and including the mid-point of the NBBO.[7] The displayed price of an MDO would be re-priced to track changes in the NBBO.[8] An MDO's sole time stamp would be the one assigned to the order at its displayed price, and it would only change when the displayed price is adjusted to track changes in the NBB or NBO to which it is pegged. Therefore, if the discretionary range of an MDO changes due to a change in the mid-point of the NBBO (i.e., if the NBO changes for an MDO to buy or if the NBB changes for an MDO to sell), an MDO's time stamp would not change.

An MDO would not independently establish or maintain the NBB or NBO; rather, the displayed price of the MDO would be derived from the NBB or NBO. Accordingly, an MDO

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[6]   EDGX Rule 1.5(o) defines "NBBO" as "the national best bid or offer." See also Rule 600(b)(42) of Regulation NMS under the Act.

[7]   See proposed EDGX Rule 11.5(c)(14). The Exchange represents that the proposed MDO is based on and would operate similarly to the Mid-Point Discretionary Order on EDGA Exchange, Inc. ("EDGA"). See Notice, supra note 3, at 16402. However, the Exchange identifies and explains four differences, which it attributes to the different fee structures used by EDGA and EDGX. Id. at 16403-05. The differences are that an MDO on EDGX, unlike an MDO on EDGA: (1) would not be eligible to execute immediately upon entry at its displayed price; (2) would not be eligible to execute against resting Discretionary Orders, including contra-side MDOs; (3) would only be eligible to execute at the mid-point of the NBBO against Mid-Point Match Orders and incoming liquidity-removing orders when their limit prices are equal to the mid-point of the NBBO; and (4) would be immediately canceled in the event a trading halt is declared by the listing market. Id.; see also infra notes 9, 13-18 and accompanying text.

[8]   See proposed EDGX Rule 11.5(c)(14).

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would be cancelled if no NBBO exists. An MDO would also be cancelled if a trading halt is

declared by the listing market.[9] An MDO would be able to join the Exchange BBO when the

Exchange BBO equals the NBBO and the EDGX Book is locked or crossed by another market.[10]

However, if an MDO displayed on the Exchange would create a locked or crossed market, the

System would automatically adjust the price of the order[11] to one minimum price variation below

the current NBO (for an MDO to buy) or to one minimum price variation above the current NBB

(for an MDO to sell) with no discretion to execute to the mid-point of the NBBO.[12]

Upon entry into the System, an MDO would not be eligible to execute immediately at its

displayed price; however, it would be eligible to execute at the mid-point of the NBBO.[13] An

MDO would be eligible to execute at its displayed price only after it has been posted to the

EDGX Book.[14]

An MDO would not be eligible to execute against resting Discretionary Orders,[15]

including contra-side MDOs.[16] An MDO would only be eligible to execute at the mid-point of

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[9]   Id. In the Notice, the Exchange explains rationale for this behavior. See supra, note 3, at 16404-05; note 7.

[10]   See proposed EDGX Rule 11.5(c)(14). EDGX Rule 1.5(d) defines "EDGX Book" as the "System's electronic file of orders."

[11]   EDGX Rule 1.5(cc) defines "System" 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."

[12]   See proposed EDGX Rule 11.5(c)(14).

[13]   Id.

[14]   In the Notice, the Exchange explains the rationale for this behavior and it identifies order types on other exchanges that it believes operate in the same manner. See supra note 3, at 16403-04; note 7.

[15]   See EDGX Rule 11.5(c)(13).

[16]   See proposed EDGX Rule 11.5(c)(14). In the Notice, the Exchange explains the rationale for this behavior. See supra, note 3, at 16404; note 7.

the NBBO against Mid-Point Match Orders[17] and incoming liquidity-removing orders when their

limit price is equal to the mid-point of the NBBO.[18] An MDO in a stock priced at $1.00 or more

would only be executed in sub-penny increments when executed at the mid-point of the NBBO

against contra-side Mid-Point Match Orders.[19] In addition, an MDO would not be eligible for

routing pursuant to EDGX Rule 11.9(b)(2).[20]

An MDO could include a limit price, by which its displayed price and discretion to the

mid-point of the NBBO would be bound.[21] Specifically, an MDO to buy or sell with a limit

price that is less than the prevailing NBB or greater than the prevailing NBO, respectively, is

posted to the EDGX Book at its limit price.[22] Further, for example, if an MDO to buy is entered

with a limit price that is less than the prevailing mid-point of the NBBO, it would have discretion

to buy only up to its limit price, not the mid-point of the NBBO. Conversely, if an MDO to buy

is entered with a limit price that is greater than the prevailing NBO, it would have discretion to

buy up to the mid-point of the NBBO and not to its limit price.[23]

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17   See EDGX Rule 11.5(c)(7).

18   See proposed EDGX Rule 11.5(c)(14). In the Notice, the Exchange explains the rationale
        for this behavior. See supra, note 3, at 16404; note 7.

19   See proposed EDGX Rule 11.5(c)(14). An MDO would execute against all other order
        types solely in whole penny increments, would not be eligible to execute against a contra-
        side MDO at the mid-point of the NBBO, and would not be displayed or ranked in sub-
        penny increments.

20   Id.

21   Id.

22   Id.

23   The Exchange notes that an MDO's discretion to trade to and including the mid-point of
        the NBBO may be limited where the only available contra-side liquidity at the mid-point
        is represented by MDOs or Non-Displayed Orders resting on the EDGX Book. See
        Notice, supra note 3, at 16402.

The Exchange also proposes to address how an MDO would comply with the National Market System Plan, also known as Limit Up/Limit Down ("LULD"), established pursuant to Rule 608 of the Act, to address extraordinary market volatility ("LULD Plan").[24] Specifically, an MDO to buy would be re-priced to the Upper Price Band and not the Protected Bid where the price of the Upper Price Band moves below an existing Protected Bid, and an MDO to sell would be re-priced to the Lower Price Band and not the Protected Offer where the price of the Lower Price Band moves above an existing Protected Offer.[25] An MDO would only execute at its displayed price and not within its discretionary ranges when: (i) the price of the Upper Price Band equals or moves below an existing Protected Bid; or (ii) the price of the Lower Price Band equals or moves above an existing Protected Offer.[26] When those conditions no longer exist, an MDO would resume trading against other orders in its discretionary range and being displayed at and pegged to the NBBO.[27]

C.   Proposed Amendments to EDGX Rule 11.8(a) – Priority

The Exchange proposes to amend EDGX Rule 11.8(a) to reflect the priority an MDO would have when it is executed within its discretionary range. Specifically, current EDGX Rule 11.8(a)(2) states that the EDGX System shall execute equally priced trading interest in time priority in the following order: (i) displayed size of limit orders; (ii) Mid-Point Match Orders;

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[24]   See Appendix A to Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012).

[25]   See proposed EDGX Rule 11.5(c)(14); EDGX Rule 11.9(a)(3). EDGX Rule 1.5(gg) states that "[t]he terms . . . Upper Price Band and Lower Price Band . . . shall have the definitions and meanings ascribed to them under the [LULD] Plan." EDGX Rule 1.5(v) defines "Protected Bid" and "Protected Offer" as "a bid or offer in a stock that is (i) displayed by an automated trading center; (ii) disseminated pursuant to an effective national market system plan; and (iii) an automated quotation that is the best bid or best offer of a national securities exchange or association."

[26]   See proposed EDGX Rule 11.5(c)(14).

[27]   Id.

(iii) non-displayed limit orders and the reserve quantity of Reserve Orders;[28] (iv) discretionary range of Discretionary Orders as set forth in current Rule 11.5(c)(13); and (v) Route Peg Orders as set forth in current Rule 11.5(c)(17). The Exchange proposes that, when an MDO executes at its displayed price, the MDO would have the same priority as that of the displayed size of a limit order, in accordance with EDGX Rule 11.8(a)(2)(A). The Exchange also proposes that, when an MDO executes within its discretionary range, the MDO would have the same priority as the discretionary range of a Discretionary Order, as set forth in Rule 11.8(a)(2)(D).[29]

In addition, the Exchange proposes to address the priority of orders when an MDO is posted to the EDGX Book. Where orders to buy (or sell) are made at the same price, EDGX Rule 11.8(a)(2) requires that the order clearly established as the first entered into the System at that price shall have precedence up to the number of shares of stock specified in the order.[30] As described above, an MDO would not be eligible to execute immediately upon entry into the System at its displayed price.[31] Instead, an MDO would be eligible to execute at its displayed price only after it has been posted to the EDGX Book (i.e., at the displayed price, it functions as a "post-only" order type). Therefore, the Exchange proposes to add subparagraph (9) to EDGX Rule 11.8(a) to provide that, in accordance with proposed Rule 11.5(c)(14), where an MDO does

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[28]   See EDGX Rule 11.5(c)(1).

[29]   The Exchange provides an example to illustrate the application of the priority rules to an MDO. See Notice, supra note 3, at 16407.

[30]   The Commission notes that the EDGX System executes equally-priced trading interest within the System in time priority within order type categories in the following order: (1) Displayed size of limit orders; (2) Mid-Point Match Orders; (3) Non-displayed limit orders and the reserve quantity of Reserve Orders; (4) Discretionary range of Discretionary Orders as set forth in Rule 11.5(c)(13); and (5) Route Peg Orders as set forth in Rule 11.5(c)(17).

[31]   See supra notes 13 thru 14and accompanying text. An MDO also would not be eligible to execute against resting Discretionary Orders, including contra-side MDOs. See supra notes 15 and 16 and accompanying text.

not execute against certain marketable contra-side interest resting on the EDGX Book, it would, notwithstanding EDGX Rule 11.8(a)(2) described above, be posted directly to the EDGX Book and would be eligible to execute against later-arriving marketable contra-side orders.

For example, assume that the NBBO is $10.00 x $10.01, and that User A[32] has submitted a Discretionary Order (a non-"post-only" order type) to buy at $10.00 with discretion to $10.01 that rests on the EDGX Book. If User B submits an MDO to sell with a limit price of $10.01, User B's MDO would not be able to execute against User A's resting Discretionary Order to buy, despite otherwise being marketable against User A. User B's MDO to sell instead would be posted to the EDGX Book and displayed at $10.01 with discretion to execute down to the mid-point of the NBBO, $10.005. If User C submits an order identical to User A's Discretionary Order, User C's Discretionary Order to buy would execute against User B's MDO Order to sell at $10.01, and User A's Discretionary Order to buy would remain on the EDGX Book, despite User A being first in time priority. The Exchange believes that precluding MDOs from executing against resting Discretionary Orders would promote just and equitable principles of trade by permitting the Exchange to offer a low-cost pricing structure while also offering an order type that provides Users the opportunity to achieve price improvement to and including the mid-point of the NBBO.[33] The Exchange also argues that, once a User's order is posted to the book (User A in the example above), such User expects to receive a rebate, and, thus, would be

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[32]   EDGX Rule 1.5(ee) defines "User" as "any Member or Sponsored Participant who is authorized to obtain access to the System pursuant to Rule 11.3."

[33]   See Notice, supra note 3, at 16408. Specifically, the Exchange stated that, if the Exchange were to allow MDOs on EDGX to execute against each other, the provider of liquidity would receive a rebate while the taker of liquidity would be charged no fee. Id. On the other hand, the Exchange states that an MDO on EDGA may execute against resting Discretionary Orders, including contra-side MDOs, because both orders would pay a fee. Id.; see also EDGA Fee Schedule available at http://www.directedge.com/Trading/EDGAFeeSchedule.aspx.

willing to forgo an execution against a later-arriving MDO at the displayed price.[34] The

Exchange further argues that, if a User is willing to pay a fee for broader execution opportunities

at the mid-point of the NBBO, that User could utilize a Mid-Point Match Order, rather than an

MDO.[35] The Exchange further states that amending its general priority structure to

accommodate scenarios similar to the one noted above is appropriate because the Exchange

believes that Users could then post aggressively-priced liquidity (by submitting an MDO)

because they will have certainty as to the fee or rebate they would pay or receive from the

Exchange if their orders are executed.[36]

III.   Proceedings to Determine Whether to Approve or Disapprove SR-EDGX-2014-05 and
         Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act[37] to

determine whether the proposed rule change should be approved or disapproved.[38] Institution of

such proceedings is appropriate at this time in view of the legal and policy issues that are raised

by the proposal and are discussed below. Institution of proceedings does not indicate that the

Commission has reached any conclusions with respect to any of the issues involved. Rather, as

described in greater detail below, the Commission seeks and encourages interested persons to

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[34]   See Notice, supra note 3, at 16408. The Exchange acknowledges that a later-arriving,
         identical Discretionary Order would act as a liquidity remover and pay a fee to execute
         against the MDO. Id. at 16403.

[35]   Id.

[36]   Id. at 16408.

[37]   15 U.S.C. 78s(b)(2)(B).

[38]   Section 19(b)(2)(B) of the Act provides that proceedings to determine whether to
         disapprove a proposed rule change must be concluded within 180 days of the date of
         publication of notice of the filing of the proposed rule change. The time for conclusion of
         the proceedings may be extended for up to an additional 60 days if the Commission finds
         good cause for such extension and publishes its reasons for so finding or if the self-
         regulatory organization consents to the extension.

comment on the proposal and provide the Commission with additional comment to inform the

Commission's analysis whether to approve or disapprove the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act, the Commission is providing notice of the

grounds for disapproval under consideration. The sections of the Act applicable to the proposed

rule change that provide the grounds for approval or disapproval under consideration are Section

6(b)(5).[39] Section 6(b)(5) of the Act[40] requires that the rules of an exchange be designed, among

other things, to prevent fraudulent and manipulative acts and practices, to promote just and

equitable principles of trade, 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 are not designed to permit unfair discrimination between customers, issuers,

brokers, or dealers.

The interaction (or non-interaction) of the MDO with other orders on the EDGX Book

raises important issues that warrant further public comment and Commission consideration.

Specifically, in certain circumstances, as described above, an incoming MDO, which functions

as a post-only order type, would not interact with a resting non-post-only order, but would

interact with an identical later-arriving non-post-only order. The Commission believes the

proposed rule change raises questions regarding: (1) whether it is unfairly discriminatory, or

inconsistent with the protection of investors and the public interest, for the later-arriving order to

have execution priority in these circumstances; and (2) whether it is inconsistent with a free and

open market and the national market system , or the protection of investors and the public

interest, for an exchange to create complex order interaction scenarios in order to maintain a

simplified fee schedule.

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[39]   15 U.S.C. 78f(b)(5).

[40]   15 U.S.C. 78f(b)(5).

IV.   Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data and arguments with respect to the concerns identified above, as well as any others they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is inconsistent with Section6(b)(5), or any other provision, of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.[41]

Interested persons are invited to submit written data, views and arguments regarding whether the proposed rule change should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposal, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the following:

1.   As proposed, an incoming MDO would not execute against certain resting orders willing to pay a take fee, but could instead execute against later-arriving orders identical to the

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[41]   Section 19(b) (2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

resting orders.[42] Would this result add unnecessary complexity to the Exchange's priority rules and the equity markets generally? Would it create opportunities for Users to effect "queue-jumping" or other strategies that might be unfair or detrimental to the markets? Please explain.

2. The Exchange asserts that, once a User's order is posted to the EDGX Book, the User expects to receive a rebate, even if it was willing to pay a take fee when the order was initially submitted.[43] Does this accurately represent User expectations? Please explain. Would such a User be willing to pay a fee to execute against an incoming MDO if the net execution price, taking into account the rebate forgone and the fee paid, is within the range of prices the User would have been willing to accept upon order entry?

3. The Exchange indicates that one reason an incoming MDO would not execute against a resting, contra-side Discretionary Order or MDO is because, in this circumstance, the provider of liquidity would receive a rebate while the taker of liquidity would be charged no fee.[44] Is it appropriate for an Exchange to address scenarios such as this – in which it would lose money – by adding complexity to the way orders interact (including overriding time priority), rather than adjusting its fee schedule?

4. What type of market participants would avail themselves of the MDO, and how and why would the order type improve market quality or otherwise promote fair and orderly markets, or the protection of investors and the public interest?

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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[42] See supra notes 15-16, 32-36 and accompanying text.

[43] See supra note 34 and accompanying text.

[44] See supra notes 15-16 and accompanying text.

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-EDGX-2014-05 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-EDGX-2014-05. 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 such 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 publicly available. All submissions should refer

to File Number SR-EDGX-2014-05 and should be submitted on or before [insert date 21 days from publication in the <u>Federal</u> <u>Register</u>]. If comments are received, any rebuttal comments should be submitted by [insert date 35 days from publication in the <u>Federal</u> <u>Register</u>].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[45]

Kevin M. O'Neill
Deputy Secretary

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[45]   17 CFR 200.30-3(a)(57).