SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64475; File No. SR-BATS-2011-015)

May 12, 2011

Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing of Proposed Rule Change by BATS Exchange, Inc. to Amend BATS Rule 11.9, entitled "Orders and Modifiers" and BATS Rule 11.13, entitled "Order Execution"

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on May 9, 2011, BATS Exchange, Inc. (the "Exchange" or "BATS") 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 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 BATS Rule 11.9, entitled "Orders and Modifiers" and BATS Rule 11.13, entitled "Order Execution."

The text of the proposed rule change is available at the Exchange's Web site 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

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

2 17 CFR 240.19b-4.

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

BACKGROUND

The Exchange proposes a change to its order handling procedures to allow both Non-Displayed Orders[3] and orders subject to price sliding that are not executable at their most aggressive price to be executed at one-half minimum price variation less aggressive than that price. The reference to the most "aggressive" price, as used in this 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 believes that the proposed change to its order handling procedures will allow for tighter spreads on the Exchange and will provide both sides of a given transaction with price improvement not otherwise available without such change.

In addition to the proposed changes to its order handling procedures, the Exchange proposes to modify the Exchange's rules to make clear that an order subject to "NMS price sliding" (as described below) can be ranked at the same price as an order displayed on the other side of the BATS Book,[4] although temporarily not executable at that price and displayed at one minimum price variation less aggressive than its price. For bids, this means that a price slid order is displayed at one minimum price variation less than the current national best offer

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3 As defined in Rule 11.9(c)(11), a Non-Displayed Order is "a market or limit order that is not displayed on the Exchange."

4 As defined in Rule 1.5(e), the BATS Book is "the System's electronic file of orders."

("NBO"), and for offers, this means that a price slid order is displayed at one minimum price variation more than the current national best bid ("NBB").

Both of the scenarios described below, (1) Non-Displayed Orders posted opposite-side, same priced displayed orders, and (2) orders subject to price sliding that are ranked at a price equal to an opposite-side displayed order, can occur when an order on either side of the market is a BATS Post Only Order. As defined in Rule 11.9(c)(6), a BATS Post Only Order is "[a]n order that is to be ranked and executed on the Exchange pursuant to Rule 11.12 and Rule 11.13(a)(1) or cancelled, as appropriate, without routing away to another trading center except that the order will not remove liquidity from the BATS Book." Accordingly, a BATS Post Only Order does not remove liquidity, but posts to the BATS Book to the extent permissible.

The Exchange's allowance of Non-Displayed Orders or ranking of price slid orders at the locking price is not inconsistent with the locked markets provision of Regulation NMS,[5] which applies to quotations that are <u>displayed</u> at prices that lock other protected quotations. In the case of a Non-Displayed Order, such an order can rest at a locking price because the Non-Displayed Order is not displayed. Similarly, although ranked at the locking price, a price slid order is expressly displayed at one minimum price variation above (below) the NBB (NBO).

<u>*NON-DISPLAYED ORDERS*</u>

Consistent with the Exchange's rule regarding priority of orders, Rule 11.12, certain Non-Displayed Orders cannot be executed by the Exchange pursuant to Rule 11.13 when such orders would be executed at prices equal to displayed orders on the opposite side of the market (the "locking price"). Specifically, if incoming orders were allowed to execute against the

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5 Rule 610(d) of Regulation NMS requires policies and procedures to avoid the display of quotations that lock or cross protected quotations. 17 CFR 242.610(d).

resting Non-Displayed Order at the locking price, such orders would receive a priority advantage over the resting, displayed order at the locking price; accordingly, such executions at the locking price are disallowed. The Exchange proposes to modify its handling of Non-Displayed Orders to optimize available liquidity for incoming orders and to provide price improvement for market participants, as further described below.

Below are examples describing the Exchange's current handling of Non-Displayed Orders, followed by examples describing the Exchange's proposed order handling procedures.

Example 1: Two Penny Spread – Current Handling:

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 \$10.12 per share, and a posted and displayed offer to sell 100 shares also at \$10.12 per share. Assume the national best bid or offer ("NBBO") is also \$10.10 by \$10.12. The BATS Book in this situation can be depicted as follows, with "ND" identifying the Non-Displayed Order:

	Bids		Offers
BATS:	\$10.12 (ND) \$10.10	X	\$10.12

If an incoming Immediate-or-Cancel ("IOC")[6] offer to sell 100 shares at \$10.11 is entered into the BATS Book, such order will be cancelled back to the User entering such order even though the resting Non-Displayed Order at \$10.12 is willing to buy at a price better than the limit price

6 As defined in Rule 11.9(b)(1), an IOC Order is a "limit order that is to be executed in whole or in part as soon as such order is received, and the portion not so executed is to be treated as cancelled."

of the offer.[7] Such cancellation will occur because an execution at the Non-Displayed Order's price of $10.12 would violate the Exchange's priority rule by giving the later arriving offer an execution ahead of the displayed offer at $10.12. If the incoming order was not an IOC, and thus, was eligible for posting, then the offer would be posted to the BATS Book at $10.11; the Non-Displayed bid would still remain on the BATS Book unexecuted. If instead the incoming offer was priced at $10.12 (which is the full price of the resting and displayed $10.12 offer), then, depending on the User's instructions, such offer would either cancel or post to the BATS Book behind the original offer in priority.

Example 2: One Penny Spread – Current Handling:

As a second example, 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 BATS Book in this situation can be depicted as follows, with "ND" identifying the Non-Displayed Order:

	Bids		Offers
BATS:	$10.11 (ND) $10.10	X	$10.11

If an incoming IOC offer to sell 100 shares at $10.10 is entered into the BATS Book, such order will be executed against the bid at $10.10 even though the resting Non-Displayed Order is willing to buy at the higher price of $10.11. As in the example above, the Exchange cannot

[7] Because the example assumes an NBBO of $10.10 (bid) by $10.12 (offer), the Exchange would not route an offer at $10.11 away from the Exchange even if it was eligible for routing, as there is no displayed liquidity to which the Exchange can route. If another market center did have a posted $10.11 bid, a $10.11 offer eligible for routing would route to that away market center.

execute the incoming order against the Non-Displayed Order because an execution at the Non-Displayed Order's price of $10.11 would violate the Exchange's priority rule by giving the later arriving offer an execution ahead of the displayed offer at $10.11. Also as in the example above, an offer at the price of the resting and displayed offer would, subject to the User's instructions, either cancel or post to the BATS Book behind the original offer in priority.

Under the scenarios described above, in order to honor its priority rule, the Exchange is rejecting orders that are otherwise marketable against liquidity available on the BATS Book or is executing incoming orders at prices worse than if it executed such orders against Non-Displayed Orders that are resting but not executable at their limit price. In order to execute such otherwise marketable orders consistent with the Exchange's priority rule, the Exchange proposes to execute a resting Non-Displayed Order at, in the case of a Non-Displayed bid, one-half minimum price variation less than the locking price, and, in the case of a Non-Displayed offer, at one-half minimum price variation more than the locking price, in the event that an order submitted to the Exchange on the side opposite such a Non-Displayed Order is a market order or limit order priced more aggressively than the locking price. For bids or offers under $1.00 per share, Non-Displayed Orders priced at the locking price will not be executed by the Exchange.[8]

Example 3: Two Penny Spread – Proposed Handling:

To demonstrate the proposed functionality as compared to the first example above, again 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

[8] With respect to securities priced below $1.00 per share, the Exchange does not believe that the proposed functionality is necessary for such securities given the ability to quote in sub-pennies. Further, market participants might have system limitations that would not recognize executions in any increment finer than $0.0001.

$10.12 per share, and a posted and displayed offer to sell 100 shares also at $10.12 per share. Assume the NBBO is also $10.10 by $10.12. The BATS Book in this situation can be depicted as follows, with "ND" identifying the Non-Displayed Order:

	Bids		Offers
BATS:	$10.12 (ND) $10.10	X	$10.12

If an incoming offer to sell 100 shares at $10.11 is entered into the BATS Book, the resting Non-Displayed Order at the locking price will be executed against the incoming offer at $10.115 per share, thus providing the resting Non-Displayed bid a half-penny of price improvement from its limit price of $10.12 and the incoming offer a half-penny of price improvement from its limit price of $10.11. If an incoming offer to sell 100 shares, priced instead at $10.10, is entered into the BATS Book, the resting Non-Displayed Order at the locking price will be executed against the incoming offer at $10.115 per share, thus providing the resting Non-Displayed bid a half-penny of price improvement from its limit price of $10.12 and the incoming offer a full penny and a half 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 $10.11 or below, which would execute against the Non-Displayed bid at a price of $10.115 per share. An offer at the full price of the resting and displayed $10.12 offer would not execute against the resting Non-Displayed bid, as such execution would still violate the original offer's priority. Instead, depending on the entering User's instructions, a later arriving offer at $10.12 would either cancel or post to the BATS Book behind the original offer in priority.

Example 4: One Penny Spread – Proposed Handling:

To demonstrate the proposed functionality as compared to the second example above, again 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 BATS 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 BATS 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. As above, 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 BATS Book behind the original $10.11 offer in priority.

ORDERS SUBJECT TO PRICE SLIDING

The Exchange also proposes to make clear in its rules, both through amending Rule 11.9 and through the proposed language for Rule 11.13, that an order subject to NMS price sliding can be ranked at a price that is locking an order displayed on the other side of the Exchange. In addition, the Exchange proposes to apply the proposed order handling procedures for Non-Displayed Orders that are otherwise non-executable to orders that are resting with a ranked price opposite a displayed order on the BATS Book.

Example 5: NMS Price Sliding

As an example of NMS price sliding generally, assume the NBB is $10.10 per share, and the Exchange's best bid is $10.09. Assume the NBO is $10.11 per share, and the Exchange has a displayed offer at that price.

	Bid		Offer
National best:	$10.10	X	$10.11
BATS best:	$10.09	X	$10.11

Next, assume the Exchange received an incoming BATS Post Only Order bid to buy at $10.11. The BATS Post Only Order would not remove the posted offer on the BATS Book at $10.11, and could not post as a bid at that price because it would lock the NBO. Such bid, assuming price sliding is enabled,[9] would instead be ranked at $10.11 and displayed by BATS as a bid at $10.10. The Result would be depicted as follows:

	Bid		Offer
National best:	$10.10	X	$10.11
BATS best:	$10.10*	X	$10.11

*Ranked at 10.11, but price slid and displayed at $10.10.

The BATS displayed $10.10 bid, ranked at $10.11, is not executable at $10.11 because any incoming order that would execute against it at the locking price would receive a priority advantage over the displayed offer at $10.11. Nonetheless, the best bid on the BATS Book is a buyer willing to pay up to $10.11. The Exchange proposes to modify its order handling procedures for orders subject to price sliding that are ranked at a price opposite an order displayed by the Exchange consistent with the modification described above for Non-Displayed Orders. Specifically, in the event an order submitted to the Exchange on the side opposite such a

9 As set forth in Rule 11.9(c)(6), BATS Post Only Orders are subject to the price sliding process by default, but User can opt-out of price sliding.

price slid order is a market order or a limit order priced more aggressively than the locking price, the Exchange will execute the resting order subject to price sliding at, in the case of a resting bid, one-half minimum price variation less than the locking price, and, in the case of a resting offer, at one-half minimum price variation more than the locking price. For bids or offers under $1.00 per share, resting orders subject to price sliding ranked at the locking price will not be executed by the Exchange.

ADDITIONAL DISCUSSION

Under all of the scenarios described above, the Non-Displayed Order or order subject to price sliding is priced at the very inside of the market but is temporarily un-executable at its full limit price due to the Exchange's priority rule and order handling procedures. The proposed change will provide incoming orders with price improvement against such aggressively priced, resting orders. The Exchange notes that by permitting a Member's Non-Displayed Order to rest at a locking price on the other side of a displayed order, the Exchange is incenting Member's to post aggressively priced liquidity, rather than discouraging such liquidity by leaving it unexecuted. Incoming orders executing against aggressively priced Non-Displayed Orders and price slid orders will derive an obvious benefit from the price improvement received. In addition, if the BATS Book changes so that such orders are no longer resting or ranked opposite a displayed order, then such orders will again be executable at their full limit price, and in the case of price slid orders, will be displayed at that price.

The Exchange is proposing a solution to address specific conditions that are a current, natural consequence of other order handling procedures of the Exchange. The Exchange believes that such specific circumstances, without modification, will continue to result in fewer executions or executions with less price improvement than the Exchange could otherwise facilitate. The Exchange 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 one-half minimum price variation. As such, the Exchange proposes to add Interpretation and Policy .01 to 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.

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 applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.[10] Specifically, the proposed change is consistent with Section 6(b)(5) of the Act,[11] 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 execute marketable orders that are currently not executed under specific scenarios that can occur will only serve to improve execution quality for participants sending orders to the Exchange. Further, the proposed change will help to provide price improvement to market participants, again, in scenarios that at times,

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10 15 U.S.C. 78f(b).

11 15 U.S.C. 78f(b)(5).

such participants are not even receiving executions from the Exchange or are receiving less price improvement than is currently available. Thus, the Exchange believes that its proposed order handling process in the scenario described in this filing will benefit market participants and their customers by allowing them greater flexibility in their efforts to fill orders and minimize trading costs.

The Exchange notes that the specific scenarios for which the Exchange is proposing an improved order handling process are possible due to the existence of orders that by definition will not remove liquidity from the BATS Book, BATS Post Only Orders. The Exchange believes that BATS Post Only Orders are consistent with the Act, particularly, Section 6(b)(5) of the Act,[12] because they help 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. BATS Post Only Orders allow Users to post aggressively priced liquidity, as such Users have certainty as to the fee or rebate they will receive from the Exchange if their order is executed. Without such ability, the Exchange believes that certain Users would simply post less aggressively priced liquidity, and prices available for market participants, including retail investors, would deteriorate. Accordingly, the Exchange believes that BATS Post Only Orders enhance the liquidity available to all market participants by allowing market makers and other liquidity providers to add liquidity to the Exchange at or near the inside of the market.

The proposed rule change is also consistent with Rule 612 of Regulation NMS.[13] Rule 612 generally prohibits a national securities exchange from displaying, ranking or accepting a

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[12] 15 U.S.C. 78f(b)(5).

[13] 17 CFR 242.612.

bid, offer or order in any NMS stock priced in an increment smaller than $0.01 if such bid, offer or order is priced at $1.00 per share or greater. Commission Staff has specifically interpreted Rule 612 to allow a market center to provide sub-penny price improvement, compared to the NBBO in an NMS stock for which sub-penny quotations are prohibited by the Rule, provided that the execution does not result from an order, quotation, or indication of interest that was itself priced in an impermissible sub-penny increment.[14] The staff also indicated that this interpretation may not apply when unconditional price improvement guarantees are involved.[15]

The proposed rule change does exactly what the response to Question 13 of the FAQs allows. The Exchange will provide price improvement in a sub-penny increment only when circumstances dictate, i.e., only: (1) when a Non-Displayed Order is resting on the opposite side of the market from a displayed order at the locking price, or (2) when an order subject to price sliding is ranked at a price opposite a displayed order.

All orders and quotations in these scenarios are accepted, displayed and/or ranked in a permissible penny increment price and are only executed in a sub-penny increment under certain limited circumstances – if the displayed order opposite the resting Non-Displayed Order or price slid order is cancelled or executed, then the Non-Displayed order or price slide order is again available at its full limit price.[16] There are also no unconditional price improvement guarantees involved.

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14 See Division of Market Regulation: Responses to Frequently Asked Questions ("FAQs") concerning Rule 612 (Minimum Pricing Increment) of Regulation NMS, Question 13 (Oct. 21, 2005).

15 Id.

16 The Exchange notes that permitting an execution in a sub-penny increment under certain limited circumstances, while never ranking the applicable orders at such sub-penny increments, has already been implemented by multiple exchanges, including the

The Exchange notes that this proposal does not propose any new policies or provisions that are unique or unproven, as the Exchange and multiple other exchanges allow orders to execute at half-penny prices.[17] The Exchange does not believe that there is anything novel or controversial about executing marketable orders in a fully transparent manner that is consistent with its other pre-existing rules, and under the proposed functionality, both sides to each transaction executed will receive at least one half penny price improvement on their orders. As stated above, Commission Staff has also publicly interpreted Rule 612 as allowing sub-penny executions due to price improvement, and arguably has encouraged such executions by stating that "…sub-penny executions due to price improvement are generally beneficial to retail investors."[18]

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

The Exchange does not believe that the proposed rule change imposes any burden 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.

Exchange, in the form of mid-point orders. See BATS Rule 11.9(c)(9) ("Mid-Point Peg Orders"); see also, NASDAQ Rule 4751(f)(4) ("Midpoint Peg" orders); NYSE Arca Equities Rule 7.31(h)(5) ("Mid-Point Passive Liquidity Orders"); EDGX Rule 11.5(c)(7) ("Mid-Point Match Orders"). The order types listed above are not displayed but can execute at the mid-point of the NBBO, including in penny-wide markets.

17 See id.

18 See Exchange Act Release No. 34-54714 at 4 (November 6, 2006), 71 FR 66352 (November 14, 2006).

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 up to 90 days (i) as the Commission may designate 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 the 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-BATS-2011-015 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-BATS-2011-015. 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-BATS-2011-015 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.[19]

Cathy H. Ahn
Deputy Secretary

[19] 17 CFR 200.30-3(a)(12).