

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68789; File No. SR-BATS-2013-005)

January 31, 2013

Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing of Proposed Rule Change to Modify the Competitive Liquidity Provider Program to, Among Other Things, Modify the Calculation of Size Event Tests

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 18, 2013, BATS Exchange, Inc. (“Exchange” or “BATS”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III 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 is filing with the Commission a proposal to amend Interpretation and Policy .02 to Rule 11.8, entitled “Competitive Liquidity Provider Program.”

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

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

<sup>2</sup> 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

On August 30, 2011, the Exchange received approval of rules applicable to the qualification, listing and delisting of securities of issuers on the Exchange.<sup>3</sup> More recently, the Exchange received approval to operate a program that is designed to incentivize certain market makers registered with the Exchange as Competitive Liquidity Providers (“CLPs”) to enhance liquidity on the Exchange in Exchange-listed securities (the “Competitive Liquidity Provider Program” or “CLP Program”).<sup>4</sup> The Program seeks to establish a venue for the execution of retail orders with greater price competition and transparency than existing execution arrangements. The Exchange subsequently adopted financial incentives for the CLP Program<sup>5</sup> and thereafter amended certain financial incentives for the CLP Program.<sup>6</sup>

The purpose of this filing is to modify Interpretation and Policy .02 of Rule 11.8 regarding certain details around the implementation of the CLP Program. Specifically, the Exchange proposes to: (1) expand the time during which the Exchange will calculate Size Event Tests (“SETs”) to between 9:25 a.m. and 4:05 p.m.; (2) calculate SETs separately for bids and

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<sup>3</sup> See Securities Exchange Act Release No. 65225 (August 30, 2011), 76 FR 55148 (September 6, 2011) (SR-BATS-2011-018).

<sup>4</sup> See Securities Exchange Act Release No. 66307 (February 2, 2012), 77 FR 6608 (February 8, 2012) (SR-BATS-2011-051).

<sup>5</sup> See Securities Exchange Act Release No. 66427 (February 21, 2012), 77 FR 11608 (February 27, 2012) (SR-BATS-2012-011).

<sup>6</sup> See Securities Exchange Act Release No. 67854 (September 13, 2012), 77 FR 58198 (September 19, 2012) (SR-BATS-2012-036).

offers; (3) provide separate daily rebates based on the greatest number of winning bid SETs and winning offer SETs; (4) increase the minimum quote to have a winning SET to five round lots; (5) require a CLP to also quote at least one round lot at or within 1.2% of the CLP's bid or offer in order to have a winning SET during Regular Trading Hours;<sup>7</sup> and (6) change the system for allocating the daily rebate to the CLPs with the highest and second highest winning SETs from a set percentage to a pro rata basis.

#### Extending the Time of the CLP Program

The Exchange is proposing to expand the time during which SETs are calculated on the Exchange. Currently, the Exchange calculates SETs at least once per second, but only during Regular Trading Hours. This Exchange proposes to expand the time during which SETs are calculated to include the period five minutes before the beginning of Regular Trading Hours and five minutes after Regular Trading Hours, or 9:25 a.m. to 4:05 p.m. The Exchange is proposing this change in order to encourage CLPs to enter aggressively priced orders immediately prior to, during, and immediately after both Opening Auctions<sup>8</sup> and Closing Auctions<sup>9</sup> in BATS listed securities.

#### Calculating SETs Separately for Bids and Offers

The Exchange also proposes to calculate SETs and provide rebates separately for bids and offers. Currently, the Exchange calculates and determines the winner(s) of each SET by adding together the total number of bid shares that a CLP is quoting at the NBB and the number

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<sup>7</sup> Regular Trading Hours is defined in BATS Rule 1.5(w).

<sup>8</sup> The process for Opening Auctions in BATS listed securities is described in BATS Rule 11.23(b).

<sup>9</sup> The process for Closing Auctions in BATS listed securities is described in BATS Rule 11.23(c).

of offer shares that the CLP is quoting at the NBO (the “Combined Shares”). The Exchange then determines the SET winner based on the highest total Combined Shares.

This proposal intends to amend Interpretation and Policy .02(g) of Rule 11.8 so that the Exchange calculates SETs separately for bids and offers. As proposed, the Exchange would evaluate a CLP’s bid quotes and offer quotes separately, meaning that the CLP or CLPs with the greatest aggregate size at the NBB will be considered to have a winning bid SET and the CLP or CLPs with the greatest aggregate size at the NBO will be considered to have a winning offer SET. No CLPs would be considered to have a winning SET for having the greatest aggregate size at the NBB and NBO combined.

#### Minimum Quote Size Requirement

The Exchange is proposing to increase the minimum quote size requirement to be eligible to have a winning SET during Regular Trading Hours. Currently, the Exchange only requires that a CLP’s orders are for at least one round lot. Specifically, this proposal to amend subparagraph (g)(4) of Interpretation and Policy .02 to Rule 11.8 is intended to increase the minimum quote size requirement to five round lots (usually 500 shares) for a CLP to have a winning bid or offer SET. The Exchange is proposing this change to encourage CLPs to provide additional liquidity at the NBBO in BATS listed securities.

#### Contra-Side Quoting Requirement

The Exchange also proposes that a CLP be required to quote at least one round lot at or within 1.2% of the CLP’s bid or offer in order to have a winning SET during Regular Trading Hours. Currently, outside of daily and monthly quoting requirements, the Exchange does not have any quoting requirements for CLPs. More specifically, the Exchange does not currently

have any contra-side quoting requirements that a CLP must meet in order to be considered to have a winning SET.

This proposal to add sub-paragraph (g)(5) to Interpretation and Policy .02 to Rule 11.8 is intended to require that, in order to have a winning bid SET or winning offer SET during Regular Trading Hours, a CLP must have a bid or offer on the contra-side at a price at or within 1.2% of the CLP's winning offer or bid, respectively. For example, as proposed, in order for a CLP to have a winning bid SET for a 500 share bid priced at \$10.00, the CLP must, at the time of the SET, also have at least one round lot offer for between \$10.00 and \$10.12. For a CLP to have a winning offer SET for a 500 share offer priced at \$10.00, the CLP must, at the time of the SET, also have at least one round lot bid priced between \$9.88 and \$10.00. The Exchange is proposing this amendment in order to require CLPs to provide liquidity on both sides of the market in order to be considered to have a winning bid or offer SET. The Exchange is proposing to have this requirement apply only to SETs during Regular Trading Hours in order to mitigate exposure due to potentially high volatility in pricing that occurs outside of Regular Trading Hours.

#### Providing Daily Financial Rebates Separately for Bid SETs and Offer SETs

The Exchange proposes to provide separate daily rebates based on the greatest number of winning bid SETs and winning offer SETs. Currently, the one or two CLPs (depending on the type of security) with the greatest number of winning SETs (subject to other requirements, not relevant for the purposes of this proposed change) win a set percentage of a single daily rebate. The Exchange is proposing, in conjunction with the above proposed change to calculate SETs separately for bids and offers, to amend Interpretation and Policy .02 (g)(1)(A) and (k)(1) of

Rule 11.8 to provide daily financial rebates to CLPs based on which CLP or CLPs have the greatest number of winning bid SETs and, separately, winning offer SETs.

#### Allocation of Daily Financial Rebates

The Exchange is also proposing to amend the way that it allocates daily financial rebates to CLPs. Currently, for all CLP eligible securities with the exception of Tier II securities,<sup>10</sup> the Exchange allocates daily financial rebates on an 80/20 basis in which the eligible CLP with the highest number of winning SETs receives 80% of the daily financial rebate and the eligible CLP with the second highest number of winning SETs receives 20% of the daily financial rebate.<sup>11</sup> Frequently, the Exchange has found that the CLP with the most or second most winning SETs will realize that they are so far in front of the next CLP and/or so far behind the CLP in front of them that they no longer have incentive to continue to provide aggressive quotes.

In order to incentivize CLPs to continue to quote aggressively throughout the day, the Exchange is proposing to amend paragraph (k)(1) of Interpretation and Policy .02 to Rule 11.8 to allocate daily financial rebates to CLPs on a pro rata basis. Specifically, the Exchange is proposing to determine the two CLPs that receive the daily financial rebates on the same basis, however, rather than receiving a pre-set percentage of the financial rebate, the CLPs will split the financial rebate based on the number of each CLP's winning SETs as a percentage of total winning SETs between the two winning CLPs. For instance, where CLP1 has 6,000 winning SETs, CLP2 has 4,000 winning SETS, and CLP3 has 3,000 winning SETs, currently, the

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<sup>10</sup> As defined in BATS Rule 14.9.

<sup>11</sup> It is worth noting that the Exchange currently does not distinguish between bid SETs and offer SETs and awards the daily financial rebates to CLPs based only on the total number of winning SETs (whether on an 80/20 basis or, as under Tier II, 100% to a single CLP). As described above, the Exchange is proposing to calculate both winning bid SETs and winning offer SETs and, as such, is also proposing to provide separate and independent financial rebates to CLPs for bid SETs and offer SETs.

Exchange would award 80% to CLP1 and 20% to CLP2, based on the set percentages. However, as proposed, CLP1 would be allocated 60% of the financial rebate  $[6,000/(6000+4000)]$  and CLP2 would be allocated 40% of the financial rebate  $[4,000/(6,000+4,000)]$ . The Exchange is not proposing to reallocate the daily financial rebates for Tier II securities.

## 2. Statutory Basis

The Exchange believes that its proposal 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.<sup>12</sup> In particular, the proposal is consistent with Section 6(b)(5) of the Act,<sup>13</sup> because it would 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. The Exchange believes that the proposal will benefit market participants by incentivizing increased participation in the Opening and Closing Auction by expanding the time during which the Exchange will conduct SETs, thus improving the price discovery process. The Exchange also believes that the proposal will promote tighter spreads for all market participants by separately calculating SETs and providing rebates for bids and offers rather than combined bids and offers, which will incentivize CLPs to quote more aggressively on both the bid and offer. Further, the Exchange believes that the proposal will promote tighter spreads by requiring that CLPs quote at least one round lot at or within 1.2% of a bid or offer in order to have a winning SET during Regular Trading Hours. In addition to creating tighter spreads, the Exchange further believes that the proposal is consistent with the Act because it will help to increase liquidity at the NBBO by increasing the minimum quote size from one round lot

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<sup>12</sup> 15 U.S.C. 78f(b).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

to five round lots. Finally, the Exchange believes that the proposed pro-rata structure will incentivize CLPs to quote aggressively on a continuous basis throughout each trading day.

(B) Self-Regulatory Organization's Statement on Burden on Competition

The proposed rule change does not impose any burden on competition. The Exchange believes that the proposal will merely improve the incentives and, in turn, the results, of its CLP Program. The Exchange believes that the proposed changes will enhance competition amongst participants in the CLP Program.

(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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will: (a) by order approve or disapprove such 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](mailto:rule-comments@sec.gov). Please include File Number SR-BATS-2013-005 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-2013-005. 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 available publicly. All submissions should refer

to File Number SR-BATS-2013-005 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>14</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).