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SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-65964; File Nos. SR-EDGA-2011-29; SR-EDGX-2011-28)

December 15, 2011

Self-Regulatory Organizations; EDGA Exchange, Inc.; EDGX Exchange, Inc.; Order Approving Proposed Rule Changes, as Modified by Amendments No. 1, Relating to Amendments to EDGA and EDGX Rules Regarding the Registration and Obligations of Market Makers

I. Introduction

On August 30, 2011, EDGA Exchange, Inc. and EDGX Exchange, Inc. (“EDGA” and “EDGX,” or “Exchanges”) 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 proposed rule changes relating to amendments to EDGA and EDGX rules regarding the registration and obligations of market makers.³ The proposed rule changes were published for comment in the Federal Register on September 16, 2011.⁴ On December 14, 2011, the Exchanges each filed an Amendment No. 1 to their respective proposed rule changes (“Amendments No. 1”).⁵ The Commission received no comment letters regarding the proposals.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The proposed rule changes, and the rules affected by them, in the EDGA and EDGX rulebooks are identical, so all proposed changes and references to any rule apply to both of the Exchanges.

⁴ See Securities Exchange Act Release No. 65315 (September 12, 2011), 76 FR 57772 (September 16, 2011) (SR-EDGX-2011-28); Securities Exchange Act Release No. 65316 (September 12, 2011), 76 FR 57787 (September 16, 2011) (SR-EDGA-2011-29) (“Notices”).

⁵ Amendments No. 1 amended the proposed rule changes to delete proposed Rule 11.21(e), which would have allowed the Exchanges, upon the request of a Market Maker, to enter, refresh, cancel and re-enter, under specified circumstances, two-sided quotations on behalf of the market maker at prices within a Designated Percentage (defined below) away from the then-current NBBO. The filings were previously noticed by the Commission for public comment in their entirety. Amendments No. 1 removed an optional automated quotation functionality, a change that does not alter the substance of

This order approves the proposed rule changes, as modified by the Amendments No. 1.

II. Description of the Proposals

The Exchanges propose to amend Chapter XI of their rulebooks to add new rules regarding the registration and obligations of market makers. The Exchanges also propose to amend Rule 14.1, entitled “Unlisted Trading Privileges,” to restrict trading activities of Market Makers, and impose a series of reporting and record-keeping requirements on them. Lastly, the Exchanges propose to amend Rule 8.15, Interpretation .01, to expand the list of violations eligible for disposition under the Exchanges’ Minor Rule Violation Plans (“MRVP”).

A. Registration of Market Makers

The Exchanges propose to give Members the option to register as Market Makers, which would require them to submit applications in the form prescribed by the Exchanges. The Exchanges would review the applications by considering several factors, including the capital, operations, personnel, technical resources, and disciplinary history of the applicant. The Exchanges would require each Market Maker to have and maintain the minimum net capital of at least the amount required by Rule 15c3-1 under the Act.⁶ An applicant’s registration as a Market Maker would become effective upon receipt by the Member of the notice of approval of registration from one of the Exchanges. The Exchanges would designate registered Market Makers as dealers for all purposes under the Act, and the rules and regulations thereunder.

The Exchanges could suspend or terminate the registration of a Market Maker if the Exchange(s) determine(s) that the Market Maker: substantially or continually fails to engage in dealings in accordance with Exchange Rules, fails to meet the minimum net capital conditions,

the remainder of the proposals. For these reasons, the amendments are not subject to notice and comment.

⁶ 17 CFR 240.15c3-1.

fails to maintain fair and orderly markets, or does not have at least one registered Market Maker Authorized Trader (“MMAT”) qualified⁷ to perform market making activities.⁸ Any Market Maker could also withdraw its registration, subject to any minimum prior notice period or other conditions on withdrawal and re-registration the Exchange(s) deem(s) appropriate to maintain fair and orderly markets.

B. Registration of MMATs

The Exchanges propose to require that each registered Market Maker have at least one registered MMAT, which would require Market Makers to submit applications in the form prescribed by the Exchanges. MMATs could be officers, partners, employees, or other associated persons of Market Makers. However, to be eligible for registration as a MMAT, a person must successfully complete the training and other programs required by the Exchanges and the General Securities Representative Examination (i.e., Series 7) or equivalent foreign examination module approved by the Exchanges. The Exchanges would require Market Makers to ensure that their MMATs are properly qualified to perform market making activities, and the Exchanges could grant a person conditional registration as a MMAT as appropriate in the interests of maintaining a fair and orderly market. Once registered, MMATs could enter orders only for the account of the Market Maker for which they are registered.

In addition, the Exchanges could suspend or terminate the registration of a MMAT if the Exchange(s) determine(s) that the MMAT has caused the Market Maker to fail to comply with the federal securities laws, and the rules and regulations thereunder, or the rules of the Exchange(s), or if the MMAT fails to perform his or her responsibilities properly or fails to

⁷ A MMAT whose registration is suspended would not be deemed qualified.

⁸ A Market Maker could appeal a suspension or termination pursuant to the procedures in Chapter X of the Exchanges’ rules.

maintain fair and orderly markets.⁹ If a MMAT is suspended, the Market Maker could not allow the MMAT to submit orders. A Market Maker could also withdraw the registration of a MMAT by submitting to the Exchange(s) a written request on a form prescribed by the Exchange(s).

C. Registration of Market Makers in a Security

The Exchanges propose to require Market Makers to register in the securities for which they would make markets. A Market Maker could register in a newly authorized security or in a security already admitted to dealings on the Exchange(s) by filing a security registration form with the Exchange(s). Registration in the security would become effective on the same day that the Exchange(s) approve(s) the registration, unless otherwise provided by the Exchange(s). In considering the approval of the registration of the Market Maker in a security, the Exchange(s) could consider the financial resources available to the Market Maker, the Market Maker's experience and past performance in making markets, the Market Maker's operational capability, the maintenance and enhancement of competition among Market Makers in each security in which they are registered, the existence of satisfactory clearing arrangements for the Market Maker's transactions, and the character of the market for the security. The Exchange(s) could suspend or terminate the registration of a Market Maker in any security whenever the Exchange(s) determine(s) that the Market Maker has not met one or more of its obligations, including a failure to maintain fair and orderly markets.¹⁰ A Market Maker also could voluntarily terminate its registration in a security by providing the Exchange(s) with a written notice of such termination, subject to any minimum prior notice period or other conditions on

⁹ A MMAT could appeal a suspension or termination pursuant to the procedures in Chapter X of the Exchanges' rules.

¹⁰ A Market Maker could appeal a suspension or termination pursuant to the procedures in Chapter X of the Exchanges' rulebooks.

termination and re-registration the Exchange(s) deem(s) appropriate.¹¹

D. Market Maker Obligations

The Exchanges propose to establish market maker obligations. In general, Market Makers would have to engage in a course of dealings for their own accounts to assist in the maintenance, insofar as reasonably practicable, of fair and orderly markets on the Exchanges. The responsibilities of a Market Maker would include, without limitation: remaining in good standing with the Exchange(s) and in compliance with all applicable rules of the Exchange(s); informing the Exchange(s) of any material change in its financial or operational condition or personnel;¹² maintaining a current list of MMATs and providing any updates to such list to the Exchange(s) upon any change in MMATs; and clearing and settling transactions through the facilities of a registered clearing agency.¹³ Market Makers would be responsible for the acts and omissions of their MMATs. If the Exchanges were to find any substantial or continued failure by a Market Maker to engage in a course of dealing as specified, such Market Maker would be subject to disciplinary action, or suspension or revocation of its registration.

The Exchanges also propose to require that Market Makers maintain continuous, two-sided quotations within a designated percentage of the National Best Bid (“NBB”) and National

¹¹ A Market Maker that fails to give advanced written notice of termination to the Exchange(s) may be subject to formal disciplinary action pursuant to Chapter VIII of the Exchanges’ rules.

¹² The Exchanges propose to include an interpretation that would remind Market Makers that, in connection with the obligation to “inform the Exchange of any material change in financial or operational condition,” the Market Makers would also be obligated to submit to the Exchange(s) a copy of a notice sent to the Commission pursuant to Rule 17a-11 under the Act. 17 CFR 240.17a-11. The notice to the Exchanges would have to be sent concurrently with the notice sent to the Commission. See proposed Rule 11.21, Interpretation .01.

¹³ Market Makers could satisfy the clearance and settlement requirement by direct participation, use of direct clearing services, or by entering into a correspondent clearing arrangement with another Member that clears trades through such agency.

Best Offer (“NBO”) (collectively, “NBBO”) (or, if there is no NBB or NBO, the last reported sale). The Exchanges represent that these Market Maker quotation requirements would be intended to eliminate trade executions against Market Maker quotations priced far away from the inside market, commonly known as “stub quotes.”¹⁴ The Exchanges further represent that the quotation obligations also would be intended to augment and work in relation to the single stock circuit breakers already in place on a pilot basis for stocks in the S&P 500[®] Index and the Russell 1000[®] Index, as well as a pilot list of Exchange Traded Products (the “Original Circuit Breaker Securities”).¹⁵ Permissible quotes would be determined by the individual character of the security, the time of day in which the quote is entered, and other factors.

For issues subject to an individual stock trading pause under the applicable rules of a primary listing market, a permissible quote (also known as “Designated Percentage”) would be as follows: (i) a Market Maker’s quotes in the Original Circuit Breaker Securities shall not be more than 8% away from the NBBO; (ii) a Market Maker’s quotes in NMS securities (as defined in Rule 600 of Regulation NMS)¹⁶ that are not Original Circuit Breaker Securities with a price equal to or greater than \$1 shall not be more than 28% away from the NBBO; and (iii) a Market Maker’s quotes in NMS securities that are not Original Circuit Breaker Securities with a price less than \$1 shall not be more than 30% away from the NBBO. For times during Regular Trading Hours¹⁷ when stock pause triggers are not in effect under the rules of the primary listing market (e.g., before 9:45 a.m. and after 3:35 p.m. Eastern Time), the Designated Percentage shall be 20% for Original Circuit Breaker Securities, 28% for all NMS securities that are not Original

¹⁴ See Notices, supra note 4: 76 FR 57772 at 57774; 76 FR 57787 at 57788.

¹⁵ Id.

¹⁶ 17 CFR 242.600.

¹⁷ See Rule 1.5(y) (as proposed to be re-lettered) (defining Regular Trading Hours as 9:30 a.m. to 4:00 p.m. Eastern Time).

Circuit Breaker Securities with a price equal to or greater than \$1, and 30% for all NMS securities that are not Original Circuit Breaker Securities with a price less than \$1.

Once a compliant quote is entered, it could rest without adjustment until such time as it moves to within 9.5% away from the NBBO for Original Circuit Breaker Securities, 29.5% away from the NBBO for NMS securities that are not Original Circuit Breaker Securities with a price equal to or greater than \$1, and 31.5% away from the NBBO for all NMS securities that are not Original Circuit Breaker Securities with a price less than \$1 (“Defined Limit”), whereupon the Market Maker would have to immediately adjust its quote to at least the permissible default level of 8%, 28%, or 30%, respectively, away from the then-current NBBO (or last reported sale, as applicable).

The Exchanges note that scenarios may occur in which pricing at the commencement of a trading day, or at the re-opening of trading in a security that has been halted, suspended, or paused, is significantly different from pricing for the security at the close of the previous trading day or immediately prior to the halt, suspension, or pause, respectively.¹⁸ The Exchanges represent that these pricing differentials could be the result of corporate actions that occur after the close of the previous trading day or the market’s absorption of material information during the halt, suspension, or pause.¹⁹ Based on this concern, the Exchanges believe that Market Makers should not be subject to the pricing obligations proposed herein when the last sale of the previous trading day, or immediately prior to a halt, is the only available reference price.²⁰ The Exchanges therefore propose that, for NMS stocks, a Market Maker would have to adhere to the pricing obligations established by this Rule during Regular Trading Hours, provided, however,

¹⁸ See Notices, supra note 4: 76 FR 57772 at 57774; 76 FR 57787 at 57789.

¹⁹ Id.

²⁰ Id.

that such pricing obligations: (i) would not commence during any trading day until after the first regular way transaction on the primary listing market in the security, as reported by the responsible single plan processor, and (ii) would be suspended during a trading halt, suspension, or pause, and would not re-commence until after the first regular way transaction on the primary listing market in the security following such halt, suspension, or pause, as reported by the responsible single plan processor. Nothing would preclude a Market Maker from voluntarily quoting at price levels that are closer to the NBBO than required under the proposal.

E. Unlisted Trading Privileges

The Exchanges propose to impose restrictions on each Market Maker on the Exchange(s) (“Restricted Market Maker”) in a derivative securities product (“UTP Derivative Security”) that derives its value from one or more currencies or commodities, or from a derivative overlying one or more currencies or commodities, or is based on a basket or index comprised of currencies or commodities (collectively, “Reference Assets”). Specifically, the Exchanges would prohibit a Restricted Market Maker in a UTP Derivative Security on the Exchange(s) from acting or registering as a market maker on any other exchange in any Reference Asset of that UTP Derivative Security, or any derivative instrument based on a Reference Asset of that UTP Derivative Security (collectively, with Reference Assets, “Related Instruments”). Further, the Exchanges would require a Restricted Market Maker to file and keep current with the Exchange(s) (in a manner prescribed by the Exchange(s)) a list identifying any accounts (“Related Instrument Trading Accounts”) for which Related Instruments are traded: (1) in which the Restricted Market Maker holds an interest; (2) over which it has investment discretion; or (3) in which it shares in the profits and/or losses. In addition, the Exchanges would prohibit a Restricted Market Maker from having an interest in, exercising investment discretion over, or

sharing in the profits and/or losses of a Related Instrument Trading Account which has not been reported to the Exchanges. In addition to the existing obligations under the Exchanges' rules regarding the production of books and records, the Exchanges would require a Restricted Market Maker, upon request by the Exchange(s), to make available 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 Restricted Market Maker in which Related Instruments are traded. Lastly, the Exchanges would require that a Restricted Market Maker not use any material, non-public information in connection with trading a Related Instrument.²¹

F. MRVPs

The Exchanges propose to add the continuous, two-sided quotation obligation to the list of rules which would be appropriate for disposition under the Exchanges' MRVPs, which would allow the Exchanges to impose a \$100 fine for each violation. The Exchanges have represented that, by promptly imposing a meaningful financial penalty for such violations, the MRVPs focus on correcting conduct before it gives rise to more serious enforcement action, provide a reasonable means of addressing rule violations that do not necessarily rise to the level of requiring formal disciplinary proceedings, and offer greater flexibility in handling certain violations.²² The Exchanges further stated that a provision that would allow the Exchanges to sanction violators under the MRVPs would not minimize the importance of compliance with the continuous, two-sided quotation obligation, and that the violation of any rule is a serious matter; the addition of a sanction under the MRVPs would be an additional method for disciplining

²¹ The Exchanges propose to re-number current Rule 14.1(c)(5) and to replace the term "components of the index or portfolio on which the UTP Derivative Security is based" in Rule 14.6(c)(6) with "Related Instruments."

²² See Notices, supra note 4: 76 FR 57772 at 57775; 76 FR 57787 at 57790.

violators.²³ The Exchanges represented that they would continue to conduct surveillance with due diligence and make determinations, on a case-by-case basis, whether a violation of the continuous, two-sided quotation obligation should be subject to formal disciplinary proceedings.

III. Discussion

After careful review of the proposals, the Commission finds that the proposed rule changes are consistent with the requirements of the Act, and the rules and regulations thereunder applicable to a national securities exchange.²⁴ In particular, the Commission finds that the proposals are consistent with Section 6(b)(5) of the Act,²⁵ which requires, among other things, that the rules of an exchange be designed 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.

The Commission finds that the Exchanges' proposals to establish procedures for the registration, withdrawal, suspension, and termination of Market Makers and MMATs; the registration of Market Makers in a security; and Market Maker obligations are consistent with Section 6(b)(5) of the Act.²⁶ The proposed rules would benefit all Exchange participants because Market Makers would assist in the maintenance of fair and orderly markets, provide additional liquidity to the Exchanges, and assist in preventing excess volatility. The Commission finds that the Exchanges' rules provide objective processes by which a Member could become a Market Maker, an individual could become an MMAT, and a Market Maker could register in a security. The proposed rules also provide for appropriate oversight by the Exchanges to monitor for

²³ Id.

²⁴ In approving these proposed rule changes, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²⁵ 15 U.S.C. 78f(b)(5).

²⁶ Id.

continued compliance by Market Makers and MMATs with the terms of those provisions. The Commission also notes that these proposals, including the Market Maker obligations, are similar to rules of other exchanges.²⁷ As a result, the Commission believes that these aspects of the proposals are consistent with the Act.

The Commission also finds that the provisions of the proposed rule changes that implement the continuous, two-sided quotation obligation are consistent with Section 6(b)(5) of the Act.²⁸ The proposed rules promote uniformity across markets concerning minimum market maker quotation requirements as this aspect of the proposals is similar to rules of other self-regulatory organizations.²⁹ In addition to Section 6(b)(5) of the Act,³⁰ the Commission finds that the continuous, two-sided quoting obligations are consistent with Section 11A(a)(1) of the Act³¹ in that they seek to assure fair competition among brokers and dealers and among exchange markets. By requiring Market Makers to maintain quotes that are priced within a specified percentage of the NBBO, the proposed rules should help assure that quotations submitted by

²⁷ See, e.g., BATS Exchange, Inc. (“BATS”) Rules 11.5-.8; National Stock Exchange, Inc. (“NSX”) Rules 11.5-.8; see also Securities Exchange Act Release Nos. 54391 (August 31, 2006), 71 FR 52836 (September 7, 2006) (SR-NSX-2006-08) (approving proposed rules for the registration of market makers, obligations of market maker authorized traders, the registration of market makers in a security, and obligations of market makers), 58644 (September 25, 2008), 73 FR 57172 (October 1, 2008) (SR-BATS-2008-005) (noticing the immediate effectiveness of proposed rules for the registration and obligations of market makers based on NSX’s rules).

²⁸ 15 U.S.C. 78f(b)(5).

²⁹ See, e.g., BATS Rule 11.8(d); NSX Rule 11.8(a)(1); see also Securities Exchange Act Release No. 63255 (November 5, 2010), 75 FR 69484 (November 12, 2010) (approving proposed rule changes, implementing enhanced market maker quotation standards, by BATS, NASDAQ OMX BX, Inc., Chicago Board Options Exchange, Incorporated, The Chicago Stock Exchange, Inc., Financial Industry Regulatory Authority, Inc., The NASDAQ Stock Market LLC, NSX, New York Stock Exchange LLC, NYSE Amex LLC, and NYSE Arca, Inc.).

³⁰ 15 U.S.C. 78f(b)(5).

³¹ 15 U.S.C. 78k-1(a)(1).

Market Makers to the Exchanges, and displayed to market participants, bear some relationship to the prevailing market price. This may reduce the risk that trades will occur at irrational prices and should promote fair and orderly markets and the protection of investors.³²

The Commission finds that the Exchanges' proposed restrictions on the trading activities of Market Makers in UTP Derivative Securities, and the imposition of reporting and record-keeping requirements on Market Makers who trade UTP Derivative Securities are consistent with Section 6(b)(5) of the Act.³³ These proposals are closely modeled on similar rules of other exchanges, which the Commission has previously approved, and do not raise any novel issues.³⁴

The Commission also finds that the Exchanges' proposals to include a Market Maker's obligation to maintain a continuous, two-sided quotation in any security in which it is registered in their MRVPs is consistent with Section 6(b)(5) of the Act,³⁵ and Sections 6(b)(1) and 6(b)(6) of the Act,³⁶ which require that the rules of an exchange enforce compliance with, and provide

³² The Commission notes, consistent with prior guidance under Regulation SHO (See Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48015 (Aug. 6, 2004) and Release No. 58775 (Oct. 14, 2008), 73 FR 61690, 61698-99 (Oct. 17, 2008)), that a market maker's compliance with the percentage quoting requirements contained in these proposals, i.e., maintaining a quote that is 8% away from the NBBO for stocks in the S&P 500, Russell 1000, and for select ETPs, would not constitute bona fide market making for purposes of claiming the applicable exceptions to the requirements of Regulation SHO.

³³ 15 U.S.C. 78f(b)(5).

³⁴ See, e.g., BATS Rule 14.1; NASDAQ OMX Phlx LLC ("Phlx") Rule 803(o); NSX Rule 15.9; see also Securities Exchange Act Release Nos. 57806 (May 9, 2008), 73 FR 28541 (May 16, 2008) (SR-Phlx-2008-34) (approving consolidation into a single rule of certain requirements for products traded on the Philadelphia Stock Exchange, Inc. (n/k/a Phlx) pursuant to unlisted trading privileges); 58623 (September 23, 2008), 73 FR 57169 (October 1, 2008) (SR-BATS-2008-004) (noticing immediate effectiveness of consolidation into a single rule of certain requirements for products traded on BATS pursuant to unlisted trading privileges consolidation).

³⁵ 15 U.S.C. 78f(b)(5).

³⁶ 15 U.S.C. 78f(b)(1), (6).

appropriate discipline for, violations of Commission and exchange rules. The Commission believes that the proposed changes to the MRVPs should strengthen the Exchanges' abilities to carry out their oversight and enforcement responsibilities as SROs by promptly imposing a financial penalty in cases where full disciplinary proceedings are unsuitable in view of the minor nature of the particular violation. The Commission also notes that these proposed changes are closely modeled on the rules of other exchanges, which have been previously approved by the Commission.³⁷ Furthermore, the Commission believes that, because Rule 8.15 provides procedural rights to a person fined under the MRVP to contest the fine and permits a hearing on the matter, the proposed changes provide a fair procedure for the disciplining of Members and persons associated with Members, consistent with Sections 6(b)(7) and 6(d)(1) of the Act.³⁸ Therefore, the Commission finds that the proposals are consistent with the public interest, the protection of investors, or otherwise in furtherance of the purposes of the Act, as required by Rule 19d-1(c)(2) under the Act,³⁹ which governs minor rule violation plans.

In approving these proposals, the Commission in no way minimizes the importance of compliance with the Exchanges' rules and all other rules subject to the imposition of fines under the MRVPs. The Commission believes that the violation of any SRO's rules, as well as Commission rules, is a serious matter. However, the MRVPs provide a reasonable means of addressing rule violations that do not rise to the level of requiring formal disciplinary proceedings, while providing greater flexibility in handling certain violations. The Commission expects that the Exchanges will continue to conduct surveillance with due diligence and make determinations based on their findings, on a case-by-case basis, whether a fine of more or less

³⁷ See BATS Rule 8.15, Interpretation .01; NSX Rule 8.15, Interpretation .01.

³⁸ 15 U.S.C. 78f(b)(7), (d)(1).

³⁹ 17 CFR 240.19d-1(c)(2).

than the recommended amount is appropriate for a violation under the MRVPs or whether a violation requires formal disciplinary action under the Exchanges' rules.

Finally, the Commission finds that the Exchanges' addition of definitions, re-lettering and re-numbering of rules, and replacement of certain text in Rule 14.1(c)(6) are technical in nature and consistent with the Act accordingly.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴⁰ that the proposed rule changes (SR-EDGA-2011-29 and SR-EDGX-2011-28), as amended by Amendments No. 1, be, and hereby are, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴¹

Kevin M. O'Neill
Deputy Secretary

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⁴⁰ 15 U.S.C. 78s(b)(2).

⁴¹ 17 CFR 200.30-3(a)(12).