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SECURITIES AND EXCHANGE COMMISSION
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September 22, 2016

Self-Regulatory Organizations; NASDAQ BX, Inc.; Notice of Filing of Proposed Rule Change to Amend BX Rules 4702 and 4703

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹, and Rule 19b-4 thereunder,² notice is hereby given that on September 13, 2016, NASDAQ BX, Inc. (“BX” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “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 BX Rules 4702, Order Types, and 4703, Order Attributes, to change the way in which Post Only Orders interact with resting Non-Display orders and preventing the execution of midpoint pegged orders during a crossed market.

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaqbx.cchwallstreet.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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange offers various Order Types³ and Order Attributes⁴ to help members trade effectively on behalf of investors and themselves. This proposal would modify the manner in which two of those order types, Non-Display and Post Only, interact within BX's trading system.

The Exchange's Non-Display Orders, described in Rule 4702(b)(3), help members minimize market impact when trading in larger-than-average size. For example, institutions often use Non-Display Orders that use pegging at the midpoint (Midpoint Peg Order)⁵ of the National Best Bid and Offer (NBBO) to reduce market impact because a midpoint execution does not indicate a price movement direction, as opposed to buying at the offer or selling at the bid (sometimes referred to as "crossing the spread") which may publicly indicate the direction of the stock price.

The Exchange also offers Post Only Orders, described in Rule 4702(b)(4), which members, often market makers, use to rest liquidity on BX's Order Book. Resting displayed liquidity is essential to price formation and order interaction, two indicators of healthy and

³ See Exchange Rule 4702. The Exchange also proposes a minor technical correction to add the word "price" after the word "displayed" in the second line of the second paragraph of Rule 4702(b)(4)(B).

⁴ See Exchange Rule 4703.

⁵ See Exchange Rule 4702(b)(3)(C).

orderly markets. BX introduced Post Only Orders⁶ to enable and encourage this valuable behavior. A Post Only buy (sell) order entered at a price below \$1.00 will execute against a resting sell (buy) order if the value of price improvement equals or exceeds the foregone rebate for liquidity provision and fee for removing liquidity. If a Post Only buy (sell) order is entered at a price below \$1.00 and is equal to the price of a resting sell (buy) order, the buy (sell) order is repriced one minimum price increment (MPV), generally \$0.0001⁷ lower (higher) than the resting sell (buy) order's price.

This repricing function, sometimes referred to as “price-sliding,” often occurs when a liquidity provider seeking to tighten the bid/offer spread on the Exchange encounters a Non-Display Order on the opposite side of market from the Post Only Order. When this occurs, the displayed spread on the Exchange may become wider than on competing exchanges therefore reducing market quality and the likelihood of execution on the Exchange. In addition, the member entering the Post Only Order learns through the repricing action both that there is a Non-Display Order resting on the book and also the price at which the Non-Display Order is resting. The Exchange believes that this interaction is inefficient and detrimental to investors, to members, and to the market.

⁶ See Post Only order Factsheet:
http://www.nasdaqtrader.com/content/ProductsServices/Trading/postonly_factsheet.pdf.

⁷ Securities priced at or above \$1 are quoted in \$0.01 increments, below \$1, they can be quoted in \$0.0001 increments. Post Only behavior is slightly different below \$1 because the fees and economics involved in the execution are distinct from those at or above \$1. Specifically, executions in securities priced at or above \$1 result in rebates for the accessor of liquidity and as such it is always in the best interest of the incoming Post-Only Order to execute in securities at or above \$1. See Exchange Rule 4702(b)(4)(A). In contrast, executions in securities priced below \$1 result in charges to the accessor of liquidity. Compare Rules 7018 (a) and (b). In both cases, the Exchange system is programmed to analyze the price improvement offered and to execute only where permitted under its rules.

Accordingly, the Exchange proposes two changes to the manner in which certain Post Only Orders respond to certain Non-Display Orders resting on the opposite side of the market. In all other instances, there will be no change. For example, Post-Only Orders will continue to execute against resting Non-Display Orders provided the price improvement associated with the execution equals or exceeds the foregone rebate for liquidity provision and fee for removing liquidity for the member entering the Post Only Order, as they do today.

First, a Post-Only Order that is entered with a price below \$1.00 and is equal to the price of a resting Non-Display Order will be posted at its limit price (or its adjusted price if applicable)⁸, rather than being re-priced as it is today. This allows the Post Only Order to lock the resting Non-Display Order.⁹ Both the displayed Post Only order and the resting Non-Display order will remain available for execution at the locking price. In this way, neither order is disadvantaged; the Exchange Bid/Offer spread is tightened; and no signal is sent to the member that entered the Post Only Order. In this scenario, efficacy is maintained or enhanced for both the Post Only Order user and the Non-Display Order user compared to today. For example, under the current rules if a Participant entered a Post-Only Order to buy at \$0.95, the Best Offer¹⁰ was \$0.97, and there was a Non-Displayed Order on the Exchange Book to sell at \$0.95, the Post-Only Order would be ranked and displayed at \$0.9499. Using the above scenario, the

⁸ If a Post-Only Order is received at a price that would lock or cross a Protected Quotations [sic], its price will be adjusted in the same manner as a Price to Comply order (if it is not Attributable) or a Price to Display Order (if it is Attributable). See Rules 4702(b)(1) and 4702(b)(4)(A).

⁹ The Exchange believes that this condition is consistent with the Regulation NMS prohibition on locked and crossed markets because the Exchange will not be displaying a locked market.

¹⁰ The term “Best Offer” is defined in Exchange Rule 4701(j).

Exchange is proposing to instead rank and display the Post-Only Order to buy at its limit price of \$0.95.

Second, the Exchange also proposes to modify processing when a Post Only Order, priced below \$1.00, interacts with a Non-Display Order that is a Midpoint Peg Order. Specifically, when a Post Only buy (sell) order is priced higher (lower) than a resting Midpoint Peg Order but where the difference is less than the foregone rebate for liquidity provision and fee for removing liquidity, the Post Only Order will nonetheless be posted at its limit price. This proposal benefits investors and members because it results in a tighter Bid/Offer spread. Moreover, because the Post Only order is not re-priced relative to the resting Midpoint Peg order, as it is today, there is no information leakage. Additionally, the member entering the Midpoint Peg Order benefits because the new midpoint based on the new NBBO would now be a better price for the seller. Midpoint Peg orders are either cancelled or re-adjusted based on NBBO changes depending on the protocol used by the member to enter the Midpoint Peg Order.¹¹ For example, under the current rules if the NBBO is \$0.92 x \$0.97 and a Participant enters a Midpoint Peg Order (which, as stated above, is Non-Displayed) to buy 200 shares with a limit price of \$0.96, the Midpoint Peg Order would post to the book at \$0.945. If thereafter a Post-Only Order to sell 200 shares at \$0.9449 is entered, the Post-Only Order would post and display at \$0.9451 and Midpoint Peg Order would be cancelled or readjusted depending on the protocol used to enter the order. Under the proposed change and using the example above, the incoming Post-Only Order to sell 200 shares at \$0.9449 would post and display at \$0.9449 and the Midpoint Peg Order would be cancelled or re-adjusted depending on the protocol used to enter the order.

¹¹ See Exchange Rule 4703(d).

In addition, the Exchange proposes to discontinue executing midpoint pegged orders when the NBBO is crossed. Today, the Exchange executes midpoint pegged orders when the NBBO is locked by executing at the locking price and when the NBBO is crossed by executing at the midpoint of the crossed price. Based upon feedback from members and the practice of other exchanges,¹² the Exchange has determined that its current practice of executing midpoint pegged orders during such crossed markets produces sub-optimal execution prices for members and investors. The midpoint of a crossed market is not a clear and accurate indication of a valid price, nor is it indicative of a fair and orderly market. The better result is to simply not execute midpoint orders during crossed markets. To accomplish this, the Exchange will program the trading system to respond to the creation of a crossed NBBO by cancelling existing midpoint pegged orders and rejecting the entry of new midpoint pegged orders. After such order cancellation or rejection, members can resubmit their orders at their discretion without limitation. Accordingly, the Exchange proposes to modify the rule language describing the processing of Orders with the midpoint pegging attribute described in Rule 4703(d).

As set forth below, the Exchange believes the proposed changes will benefit investors and members by addressing certain market inefficiencies that exist on the Exchange, and by improving BX's competitive position against other exchanges that already offer similar processing of resting and non-displayed orders.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,¹³ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹⁴ in particular, in that it is

¹² See, e.g., BATS Rule 11.9(c)(9) (no midpoint execution during crossed market); NYSE Arca Rule 7.31(d)(4) (no midpoint execution when the market is locked or crossed).

¹³ 15 U.S.C. 78f(b).

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 in several ways.

First, the proposed changes will benefit investors and members by tightening bid/offer spreads, thereby enhancing execution quality on the Exchange. Second, members entering Post Only Order users will be able to execute liquidity providing strategies more efficiently. Third, the proposed changes will reduce the signaling created today by the interaction of Post Only and Non-Display Order, and thereby minimize the market impact of larger orders. Fourth, the cancellation or rejection of midpoint pegged orders when the NBBO is crossed will avoid mispriced executions and result in higher overall execution quality for members.

The Exchange believes the proposed changes have no detrimental impact on any member or class of members, or on users of the Post Only or Non-Display Order types or on users of other order types offered by the Exchange. First, the use of Exchange Order types and attributes is voluntary, in that no member is required to use any specific Order type or attribute or even to use any Exchange Order type or attribute or any Exchange functionality at all. If an Exchange member believes for any reason that the proposed rule change will be detrimental, that perceived detriment can be avoided by choosing not to enter or interact with the Order types modified by this proposed rule change. Second, the Exchange believes that the changes proposed herein will not result in any diminution of market quality (execution price, effective spread, fill rate, etc.) for any member entering or interacting with one of the Order types modified by this proposed rule change.

¹⁴ 15 U.S.C. 78f(b)(5).

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. To the contrary, the Exchange believes the proposed rule changes are pro-competitive for several reasons. First, the proposed functionality is designed to compete with exchanges, including BATS and NYSE Arca, which already offer order types that behave similarly to how the Exchange proposes Post Only and Non-Display Orders behave in the future. Second, the Exchange believes that the proposed rule change will make the Exchange a more competitive execution venue by creating tighter bid/offer spreads and by enhancing execution quality (i.e., achieving increased price improvement, reducing effective spreads, and increasing execution fill rates). Third, the Exchange proposes to offer the same functionality to all members, thereby eliminating potential competitive burden or differential treatment.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

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-BX-2016-046 on the subject line.

Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-BX-2016-046. 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-BX-2016-046 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.¹⁵

Brent J. Fields
Secretary

¹⁵ 17 CFR 200.30-3(a)(12).

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