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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-62716; File No. 10-198]

### In the Matter of the Application of BATS Y-Exchange, Inc. for Registration as a National Securities Exchange Findings, Opinion, and Order of the Commission

August 13, 2010.

#### I. Introduction

On October 20, 2009, BATS Y-Exchange, Inc. (“BATS Y Exchange” or “Exchange”) submitted to the Securities and Exchange Commission (“Commission”) a Form 1 application (“Form 1”) under the Securities Exchange Act of 1934 (“Act”), seeking registration as a national securities exchange pursuant to Section 6 of the Act.<sup>1</sup> Notice of the application was published for comment in the *Federal Register* on January 28, 2010.<sup>2</sup> The Commission received no comments regarding the BATS Y Exchange Form 1. On July 1, 2010, BATS Y Exchange submitted Amendment No. 1 to its Form 1.<sup>3</sup>

<sup>1</sup> 15 U.S.C. 78f.

<sup>2</sup> See Securities Exchange Act Release No. 61400 (January 22, 2010), 75 FR 4595 (“Notice”).

<sup>3</sup> In Amendment No. 1, the Exchange modified its application by amending or adding the following rules to align the proposed rules of BATS Y Exchange with the rules of BATS Exchange, Inc. (“BATS Exchange”) as of the date of the Amendment, due to changes to BATS Exchange rules filed with and approved by the Commission or filed as immediately effective, as applicable, since the Form 1 was filed: Table of Contents; Rule 1.6 (Procedures for Exemptions); Rule 2.5 Interpretation and Policy .02 (Continuing Education Requirements); Rule 2.5 Interpretation and Policy .03 (Registration Procedures); Rule 2.5 Interpretation and Policy .04 (Termination of Employment); Rule 2.6(g) (Application Procedures for Membership or to become an Associated person of a Member); Rule 2.13 (Fidelity Bonds); Rule 3.22 (Gratuities); Rule 5.5 (Prevention of the Misuse of Material, Non-Public Information); Rule 11.9(c)(12) (Destination Specific Order); and Rule 12.13 (Trading Ahead of Research Reports). In addition, the Exchange modified certain Exhibits to the Form 1 to: (1) Reflect minor changes to certain corporate documents; (2) update the Exchange’s proposed User’s manual and certain administrative documents; (3) include a representation that the Exchange’s parent corporation will make a capital contribution into the Exchange’s capital account and provide adequate funding of Exchange operations; (4) update the list of anticipated Exchange officers; (5) indicate that the Exchange has executed a regulatory services agreement with

#### II. Statutory Standards

Under Sections 6(b) and 19(a) of the Act,<sup>4</sup> the Commission shall by order grant a registration as a national securities exchange if it finds that the exchange is so organized and has the capacity to carry out the purposes of the Act and can comply, and can enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange.

As discussed in greater detail below, the Commission finds that BATS Y Exchange’s application for exchange registration meets the requirements of the Act and the rules and regulations thereunder. Further, the Commission finds that the proposed rules of BATS Y Exchange are consistent with Section 6 of the Act in that, among other things, they are designed to: (1) Assure fair representation of an exchange’s members in the selection of its directors and administration of its affairs and provide that, among other things, one or more directors shall be representative of investors and not be associated with the exchange, or with a broker or dealer; (2) prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, remove impediments to and perfect the mechanisms of a free and open market and a national market system; and (3) protect investors and the public interest. The Commission also believes that the rules of BATS Y Exchange are consistent with Section 11A of the Act.<sup>5</sup> Finally, the Commission finds that the proposed rules of BATS Y Exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.<sup>6</sup>

#### III. Discussion

##### A. Corporate Structure

BATS Y Exchange has applied to the Commission to register as a national

the Financial Industry Regulatory Authority (“FINRA”) to conduct various regulatory services on behalf of the Exchange; and (6) indicate that the Exchange intends to file with the Commission a plan setting forth the allocation of certain regulatory responsibilities between itself and FINRA pursuant to Rule 17d-2 of the Act for Members of the Exchange that are also members of FINRA. The changes proposed in Amendment No. 1 either are not material or are otherwise responsive to the concerns of Commission staff.

<sup>4</sup> 15 U.S.C. 78f(b) and 78s(a).

<sup>5</sup> 15 U.S.C. 78k-1.

<sup>6</sup> 15 U.S.C. 78f(b)(8).

securities exchange. BATS Global Markets, Inc. (“BATS Global Markets”), a Delaware corporation, will wholly own BATS Y Exchange as well as (1) BATS Exchange, a registered national securities exchange, and (2) BATS Trading, Inc. (“BATS Trading”), a registered broker-dealer that currently provides order routing services to BATS Exchange, and would provide such services to BATS Y Exchange.

1. Self-Regulatory Function of BATS Y Exchange; Relationship Between BATS Global Markets, Inc. and BATS Y Exchange; Jurisdiction Over BATS Global Markets, Inc.

Although BATS Global Markets will not itself carry out regulatory functions, its activities with respect to the operation of BATS Y Exchange must be consistent with, and not interfere with, the Exchange’s self-regulatory obligations. The proposed BATS Global Markets corporate documents include certain provisions that are designed to maintain the independence of the Exchange’s self-regulatory function from BATS Global Markets, enable the Exchange to operate in a manner that complies with the federal securities laws, including the objectives of Sections 6(b) and 19(g) of the Act, and facilitate the ability of the Exchange and the Commission to fulfill their regulatory and oversight obligations under the Act.<sup>7</sup>

For example, BATS Global Markets submits to the Commission’s jurisdiction with respect to activities relating to BATS Y Exchange,<sup>8</sup> and agrees to provide the Commission and BATS Y Exchange with access to its books and records that are related to the operation or administration of BATS Y Exchange.<sup>9</sup> In addition, to the extent they are related to the operation or administration of BATS Y Exchange, the books, records, premises, officers, directors, agents, and employees of BATS Global Markets shall be deemed the books, records, premises, officers, directors, agents, and employees of BATS Y Exchange for purposes of, and subject to oversight pursuant to, the Act.<sup>10</sup> BATS Global Markets also agrees to keep confidential non-public information relating to the self-

<sup>7</sup> See BATS Global Markets proposed Amended and Restated By-Laws Article XII and Article XIV, Sections 14.01, 14.02, 14.03, 14.04, 14.05, and 14.06.

<sup>8</sup> See BATS Global Markets proposed Amended and Restated By-Laws Article XIV, Section 14.05.

<sup>9</sup> See BATS Global Markets proposed Amended and Restated By-Laws Article XIV, Section 14.03.

<sup>10</sup> *Id.*

regulatory function<sup>11</sup> of BATS Y Exchange and not to use such information for any non-regulatory purpose.<sup>12</sup> In addition, the board of directors of BATS Global Markets, as well as its officers, employees, and agents, are required to give due regard to the preservation of the independence of the Exchange's self-regulatory function.<sup>13</sup> Further, BATS Global Markets By-Laws require that any changes to the BATS Global Markets Certificate of Incorporation and By-Laws be submitted to the Board of Directors of the Exchange ("Exchange Board"), and, if such amendment is required to be filed with the Commission pursuant to Section 19(b) of the Act, such change shall not be effective until filed with, or filed with and approved by, the Commission.<sup>14</sup> The Commission finds that these provisions are consistent with the Act, and that they will assist the Exchange in fulfilling its self-regulatory obligations and in administering and complying with the requirements of the Act.

The Commission also believes that under Section 20(a) of the Act<sup>15</sup> any person with a controlling interest in BATS Y Exchange would be jointly and severally liable with and to the same extent that BATS Y Exchange is liable under any provision of the Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. In addition, Section 20(e) of the Act<sup>16</sup> creates aiding and abetting liability for any person who knowingly provides substantial assistance to another person in violation of any provision of the Act or rule thereunder. Further, Section 21C of the Act<sup>17</sup> authorizes the Commission to enter a cease-and-desist order against any person who has been "a cause of" a violation of any provision of the Act through an act or omission that the person knew or should have known would contribute to the violation. These

<sup>11</sup> This requirement to keep confidential non-public information relating to the self-regulatory function shall not limit the Commission's ability to access and examine such information or limit the ability of directors, officers, or employees of BATS Global Markets to disclose such information to the Commission. See BATS Global Markets proposed Amended and Restated By-Laws Article XIV, Section 14.02.

<sup>12</sup> See BATS Global Markets proposed Amended and Restated By-Laws Article XIV, Section 14.02.

<sup>13</sup> See BATS Global Markets proposed Amended and Restated By-Laws Article XIV, Section 14.01.

<sup>14</sup> See BATS Global Markets proposed Amended and Restated Certificate of Incorporation TWELFTH and BATS Global Markets proposed Amended and Restated By-Laws Article XII.

<sup>15</sup> 15 U.S.C. 78t(a).

<sup>16</sup> 15 U.S.C. 78t(e).

<sup>17</sup> 15 U.S.C. 78u-3.

provisions are applicable to BATS Global Markets' dealings with BATS Y Exchange.

## 2. Ownership and Voting Limitations; Changes in Control of BATS Y Exchange

The BATS Global Markets proposed Amended and Restated Certificate of Incorporation includes restrictions on the ability to own and vote shares of capital stock of BATS Global Markets.<sup>18</sup> These limitations are designed to prevent any shareholder from exercising undue control over the operation of BATS Y Exchange and to assure that the Exchange and the Commission are able to carry out their regulatory obligations under the Act.

Generally, no person, either alone or together with its related persons,<sup>19</sup> may beneficially own more than forty percent of any class of capital stock of BATS Global Markets.<sup>20</sup> The BATS Global Markets proposed Amended and Restated Certificate of Incorporation prohibits BATS Y Exchange members, either alone or together with their related persons, from beneficially owning more than twenty percent of shares of any class of capital stock of BATS Global Markets.<sup>21</sup> If any stockholder violates these ownership limits, BATS Global Markets will redeem the shares in excess of the applicable ownership limit for their fair market value.<sup>22</sup> In addition, no person, alone or together with its related persons, may vote or cause the voting of more than twenty percent of the voting power of the then issued and outstanding capital stock of BATS Global Markets.<sup>23</sup> If any stockholder

<sup>18</sup> These provisions are generally consistent with ownership and voting limits approved by the Commission for other SROs. See e.g., Securities Exchange Act Release Nos. 61698 (March 12, 2010), 75 FR 13151 (March 18, 2010) (order granting the exchange registration of EDGX Exchange, Inc. and EDGA Exchange, Inc.) ("EDGX and EDGA Exchange Order"); 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (File No. 10-182) (order granting the exchange registration of BATS Exchange, Inc.) ("BATS Exchange Order"); 53963 (June 8, 2006), 71 FR 34660 (June 15, 2006) (File No. SR-NSX-2006-03) ("NSX Demutualization Order"); 51149 (February 8, 2005), 70 FR 7531 (February 14, 2005) (File No. SR-CHX-2004-26) ("CHX Demutualization Order"); and 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (File No. SR-Phlx-2003-73) ("Phlx Demutualization Order").

<sup>19</sup> See BATS Global Markets proposed Amended and Restated Certificate of Incorporation FIFTH (a)(ii).

<sup>20</sup> See BATS Global Markets proposed Amended and Restated Certificate of Incorporation FIFTH (b)(i)(A).

<sup>21</sup> See BATS Global Markets proposed Amended and Restated Certificate of Incorporation FIFTH (b)(i)(B).

<sup>22</sup> See BATS Global Markets proposed Amended and Restated Certificate of Incorporation FIFTH (e).

<sup>23</sup> See BATS Global Markets proposed Amended and Restated Certificate of Incorporation FIFTH (b)(i)(C).

purports to vote, or cause the voting of, shares that would violate this voting limit, BATS Global Markets will not honor such vote in excess of the voting limit.<sup>24</sup>

The BATS Global Markets Board may waive the forty percent ownership limitation applicable to non-BATS Y Exchange member stockholders and the twenty percent voting limitation, pursuant to a resolution duly adopted by the Board of Directors, if it makes certain findings. Any such waiver would not be effective until approved by the Commission pursuant to Section 19 of the Act.<sup>25</sup> However, as long as BATS Global Markets directly or indirectly controls BATS Y Exchange, the BATS Global Markets Board cannot waive the voting and ownership limits above twenty percent for BATS Y Exchange members and their related persons.<sup>26</sup>

Members that trade on an exchange traditionally have ownership interests in such exchange. As the Commission has noted in the past, however, a member's interest in an exchange could become so large as to cast doubt on whether the exchange can fairly and objectively exercise its self-regulatory responsibilities with respect to that member.<sup>27</sup> A member that is a controlling shareholder of an exchange might be tempted to exercise that controlling influence by directing the exchange to refrain from, or the exchange may hesitate to, diligently monitor and surveil the member's conduct or diligently enforce its rules and the federal securities laws with respect to conduct by the member that violates such provisions.

In addition, as proposed, BATS Y Exchange will be a wholly-owned subsidiary of BATS Global Markets. The BATS Y Exchange proposed Amended and Restated By-Laws identifies this ownership structure.<sup>28</sup> Any changes to

<sup>24</sup> See BATS Global Markets proposed Amended and Restated Certificate of Incorporation FIFTH (d).

<sup>25</sup> See BATS Global Markets proposed Amended and Restated Certificate of Incorporation FIFTH (b)(ii)(B).

<sup>26</sup> These provisions are generally consistent with waiver of ownership and voting limits approved by the Commission for other SROs. See e.g., EDGX and EDGA Exchange Order, *supra* note 18; BATS Exchange Order, *supra* note 18; NSX Demutualization Order, *supra* note 18; CHX Demutualization Order, *supra* note 18; and Securities Exchange Act Release No. 49718 (May 17, 2004), 69 FR 29611 (May 24, 2004) (SR-PCX-2004-08).

<sup>27</sup> See, e.g., Securities Exchange Act Release Nos. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131) ("Nasdaq Exchange Registration Order") and 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) ("NYSE/Archipelago Merger Approval Order").

<sup>28</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article I(c).

the BATS Y Exchange Amended and Restated By-Laws, including any change in the provision that identifies BATS Global Markets as the sole owner, must be filed with and approved by the Commission pursuant to Section 19 of the Act.<sup>29</sup> Further, pursuant to the BATS Y Exchange proposed Amended and Restated By-Laws, BATS Global Markets may not transfer or assign, in whole or in part, its ownership interest in BATS Y Exchange.<sup>30</sup>

The Commission believes that these provisions are consistent with the Act. These requirements should minimize the potential that a person could improperly interfere with or restrict the ability of the Commission or the Exchange to effectively carry out their regulatory oversight responsibilities under the Act.

### 3. BATS Y Exchange

BATS Y Exchange has applied to the Commission to register as a national securities exchange. As part of its exchange application, the Exchange has filed the BATS Y Exchange Certificate of Incorporation and the proposed Amended and Restated By-Laws of BATS Y Exchange. In these documents, among other things, BATS Y Exchange establishes the composition of the Exchange Board and the BATS Y Exchange committees.

#### a. The BATS Y Exchange Board of Directors

The Exchange Board will be the governing body of BATS Y Exchange and possess all of the powers necessary for the management of the business and affairs of the Exchange and the execution of its responsibilities as an SRO. Under the BATS Y Exchange proposed Amended and Restated By-Laws:

- The Exchange Board will be composed of ten directors;<sup>31</sup>
- One director will be the Chief Executive Officer of BATS Y Exchange;<sup>32</sup>
- The number of Non-Industry Directors,<sup>33</sup> including at least one Independent Director,<sup>34</sup> will equal or

exceed the sum of the number of Industry Directors<sup>35</sup> and Member Representative Directors;<sup>36</sup> and

- At least twenty percent of the directors on the Exchange Board will be Member Representative Directors.<sup>37</sup>

BATS Global Markets will appoint the initial Exchange Board, including the Member Representative Directors, which shall serve until the first annual meeting of stockholders.<sup>38</sup> The first annual meeting of the stockholders will be held prior to BATS Y Exchange commencing operations as a national securities exchange.<sup>39</sup> At the first annual meeting of stockholders, a new Exchange Board will be elected pursuant to the BATS Y Exchange proposed Amended and Restated By-Laws. Therefore, prior to commencing operations as a national securities exchange, BATS Y Exchange Members will have the opportunity to participate in the selection of Member Representative Directors, and the Exchange Board will be in compliance with the compositional requirements contained in the BATS Y Exchange proposed Amended and Restated By-Laws.<sup>40</sup>

BATS Global Markets will appoint the initial Nominating Committee<sup>41</sup> and

Exchange Member; *provided*, however, that an individual who otherwise qualifies as an Independent Director shall not be disqualified from serving in such capacity solely because such Director is a Director of the [Exchange] or its stockholder." See BATS Y Exchange proposed Amended and Restated By-Laws Article I(f).

<sup>35</sup> Generally, an "Industry Director" is, among other things, a Director that is or has been within the past three years an officer, director, employee, or owner of a broker-dealer. In addition, persons who have a consulting or employment relationship with the Exchange and its affiliates, are considered "Industry." See BATS Y Exchange proposed Amended and Restated By-Laws Article I(o).

<sup>36</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article III, Section 2(b)(i).

<sup>37</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article III, Section 2(b)(ii). "Member Representative Director" means a "Director who has been appointed as such to the initial Board of Directors pursuant to Article III, Section 4(g) of these By-Laws, or elected by stockholders after having been nominated by the Member Nominating Committee or by an Exchange Member pursuant to these By-Laws and confirmed as the nominee of Exchange Members after majority vote of Exchange Members, if applicable. A Member Representative Director must be an officer, director, employee, or agent of an Exchange Member that is not a Stockholder Exchange Member." See BATS Y Exchange proposed Amended and Restated By-Laws Article III, Section 4(b).

<sup>38</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article I(s) and Article III, Section 4(g).

<sup>39</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article IV, Section 1(b).

<sup>40</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article III, Section 2.

<sup>41</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article VI, Section 2. The

Member Nominating Committee,<sup>42</sup> consistent with each committee's compositional requirements,<sup>43</sup> to nominate candidates for election to the Exchange Board. Each of the Nominating Committee and Member Nominating Committee, after completion of its respective duties for nominating directors for election to the Board for that year, shall nominate candidates to serve on the succeeding year's Nominating Committee or Member Nominating Committee, as applicable. Additional candidates for the Member Nominating Committee may be nominated and elected by BATS Y Exchange Members pursuant to a petition process.<sup>44</sup>

The Nominating Committee will nominate candidates for each director position other than the Member Representative Directors, and BATS Global Markets, as the sole shareholder, will elect those directors. The Member Nominating Committee will nominate candidates for each Member Representative Director position on the Exchange Board.<sup>45</sup> Additional candidates may be nominated for the Member Representative Director positions by BATS Y Exchange Members pursuant to a petition process.<sup>46</sup> If no candidates are nominated pursuant to a petition process, then the initial nominees of the Member Nominating Committee will be nominated as Member Representative Directors by the Nominating Committee. If a petition process produces additional candidates, then the candidates nominated pursuant to a petition process, together with those nominated by the Member Nominating Committee, will be presented to BATS Y Exchange

Nominating Committee will be comprised of at least three directors, and the number of Non-Industry members on the Nominating Committee must equal or exceed the number of Industry members.

<sup>42</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article VI, Section 3. The Member Nominating Committee will be comprised of at least three directors, and each member of the Member Nominating Committee shall be a Member Representative member.

<sup>43</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article VI, Section 1.

<sup>44</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article VI, Section 1.

<sup>45</sup> The Member Nominating Committee will solicit comments from BATS Y Exchange Members for the purpose of approving and submitting names of candidates for election to the position of Member Representative Director. See BATS Y Exchange proposed Amended and Restated By-Laws Article III, Section 4(b).

<sup>46</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article III, Section 4(c). The petition must be signed by executive representatives of ten percent or more of the Exchange members. No Exchange member, together with its affiliates, may account for more than fifty percent of the signatures endorsing a particular candidate. *Id.*

<sup>29</sup> See 15 U.S.C. 78s.

<sup>30</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article IV, Section 7.

<sup>31</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article III, Section 2(a).

<sup>32</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article III, Section 2(b).

<sup>33</sup> "Non-Industry Director" means a Director who is an Independent Director or any other individual who would not be an Industry Director. See BATS Y Exchange proposed Amended and Restated By-Laws Article I(v).

<sup>34</sup> "Independent Director" means a "Director who has no material relationship with the [Exchange], or any Exchange Member or any affiliate of any such

Members for election to determine the final nomination of Member Representative Directors.<sup>47</sup> The candidates who receive the most votes will be nominated as Member Representative Directors by the Nominating Committee.<sup>48</sup> BATS Global Markets, as the sole shareholder, will elect those candidates nominated by the Nominating Committee as Member Representative Directors.<sup>49</sup>

The Commission believes that the requirement in the BATS Y Exchange proposed Amended and Restated By-Laws that twenty percent of the directors be Member Representative Directors and the means by which they are chosen by members provides for the fair representation of members in the selection of directors and the administration of BATS Y Exchange consistent with the requirement in Section 6(b)(3) of the Act.<sup>50</sup> As the Commission has previously noted, this requirement helps to ensure that members have a voice in the use of self-regulatory authority, and that an exchange is administered in a way that is equitable to all those who trade on its market or through its facilities.<sup>51</sup>

The Commission has previously stated its belief that the inclusion of public, non-industry representatives on exchange oversight bodies is critical to an exchange's ability to protect the public interest.<sup>52</sup> Further, public, non-industry representatives help to ensure that no single group of market participants has the ability to systematically disadvantage other market participants through the exchange governance process. The Commission believes that public directors can provide unique, unbiased perspectives, which should enhance the ability of the Exchange Board to address issues in a non-discriminatory fashion and foster the integrity of BATS Y

Exchange.<sup>53</sup> The Commission believes that the proposed composition of the Exchange Board satisfies the requirements in Section 6(b)(3) of the Act,<sup>54</sup> which requires that one or more directors be representative of issuers and investors and not be associated with a member of the exchange, or with a broker or dealer.<sup>55</sup>

#### b. BATS Y Exchange Committees

In the BATS Y Exchange proposed Amended and Restated By-Laws, BATS Y Exchange has proposed to establish several committees. Specifically, BATS Y Exchange has proposed to establish the following committees that would be appointed by the Chairman of the Exchange Board, with the approval of the Exchange Board: A Compensation Committee;<sup>56</sup> Audit Committee;<sup>57</sup> Regulatory Oversight Committee;<sup>58</sup> Appeals Committee;<sup>59</sup> Executive Committee;<sup>60</sup> and Finance Committee.<sup>61</sup> In addition, BATS Y Exchange has proposed to establish a Nominating

Committee<sup>62</sup> and a Member Nominating Committee, which would be elected on an annual basis by vote of stockholders.<sup>63</sup> The Commission believes that BATS Y Exchange's proposed committees should enable BATS Y Exchange to carry out its responsibilities under the Act and are consistent with the Act.

#### B. Regulation of BATS Y Exchange

As a prerequisite for the Commission's approval of an exchange's application for registration, an exchange must be organized and have the capacity to carry out the purposes of the Act.<sup>64</sup> Specifically, an exchange must be able to enforce compliance by its members, and persons associated with its members, with the federal securities laws and the rules of the exchange.<sup>65</sup>

##### 1. Membership

Membership on BATS Y Exchange will be open to any registered broker or dealer that is a member of another registered national securities exchange or association (other than or in addition to BATS Exchange), or any natural person associated with such a registered broker or dealer.<sup>66</sup> To remain eligible for membership in BATS Y Exchange, a BATS Y Exchange member must be a member of another SRO at all times.<sup>67</sup>

For a temporary 90-day period after approval of BATS Y Exchange's application, an applicant that is a current member of BATS Exchange and an active member of another SRO will be able to apply through an expedited process to become a BATS Y Exchange member by submitting a waive-in application form, including membership agreements.<sup>68</sup> BATS Y Exchange may request additional documentation in addition to the waive-in application form in order to determine that a waive-

<sup>47</sup> See Nasdaq Exchange Registration Order and NYSE/Archipelago Merger Approval Order, *supra* note 27; BATS Exchange Order, *supra* note 18; and EDGX and EDGA Exchange Order, *supra* note 18.  
<sup>54</sup> 15 U.S.C. 78f(b)(3).

<sup>55</sup> The number of Non-Industry Directors on the Exchange Board must equal or exceed the sum of the Industry and Member Representative Directors, and the Exchange Board must include at least one Independent Director. See BATS Y Exchange proposed Amended and Restated By-Laws Article III, Section 2(b)(i).

<sup>56</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article V, Section 6(a). The Compensation Committee will be comprised of at least three people, and each voting member of the Compensation Committee shall be a Non-Industry Director. *Id.*

<sup>57</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article V, Section 6(b). The Audit Committee will be comprised of at least three people, and a majority of the Audit Committee members shall be Non-Industry Directors and a Non-Industry Director shall serve as Chairman of the Audit Committee. *Id.*

<sup>58</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article V, Section 6(c). The Regulatory Oversight Committee will be comprised of at least three people, and each member of the Regulatory Oversight Committee shall be a Non-Industry Director. *Id.*

<sup>59</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article V, Section 6(d). The Appeals Committee shall consist of one Independent Director, one Industry Director, and one Member Representative Director. *Id.*

<sup>60</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article V, Section 6(e). The number of Non-Industry Directors on the Executive Committee shall equal or exceed the number of Industry Directors. The percentage of Independent Directors on the Executive Committee shall be at least as great as the percentage of Independent Directors on the whole Exchange Board, and the percentage of Member Representative Directors on the Executive Committee shall be at least as great as the percentage of Member Representative Directors on the whole Exchange Board. *Id.*

<sup>61</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article V, Section 6(f).

<sup>62</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article VI, Section 2, and *supra* note 41.

<sup>63</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article VI, Section 1, and *supra* note 42. Additional candidates for the Member Nominating Committee may be nominated and elected by BATS Exchange members pursuant to a petition process. See *supra* note 46 and accompanying text.

<sup>64</sup> See Section 6(b)(1) of the Act, 15 U.S.C. 78f(b)(1).

<sup>65</sup> *Id.* See also Section 19(g) of the Act, 15 U.S.C. 78s(g).

<sup>66</sup> See BATS Y Exchange Rules 2.3 and 2.5(a)(4). BATS Y Exchange will only have one class of membership, with all members enjoying the same rights and privileges on the Exchange. Although BATS Y Exchange will permit members to register as Exchange Market Makers, such Market Makers will not receive special privileges or rights vis-à-vis other members.

<sup>67</sup> *Id.*

<sup>68</sup> See BATS Y Exchange Rule 2.4.

<sup>47</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article III, Section 4(e) and (f). Each BATS Y Exchange Member shall have the right to cast one vote for each available Member Representative Director nomination, provided that any such vote must be cast for a person on the List of Candidates and that no BATS Y Exchange Member, together with its affiliates, may account for more than twenty percent of the votes cast for a candidate. *Id.*

<sup>48</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article III, Section 4(f).

<sup>49</sup> *Id.*

<sup>50</sup> 15 U.S.C. 78f(b)(3).

<sup>51</sup> See Nasdaq Exchange Registration Order and NYSE/Archipelago Merger Approval Order, *supra* note 27; BATS Exchange Order, *supra* note 18; and EDGX and EDGA Exchange Order, *supra* note 18.

<sup>52</sup> See, e.g., Regulation of Exchanges and Alternative Trading Systems, Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) ("Regulation ATS Release").

in applicant meets BATS Y Exchange's qualification standards.<sup>69</sup>

All other applicants (and after the 90-day period has ended, those that could have waived in through the expedited process) may apply for membership in BATS Y Exchange by submitting a full membership application to BATS Y Exchange.<sup>70</sup> Applications for association with an Exchange Member shall be submitted to the Exchange on Form U-4 and such other forms as BATS Y Exchange may prescribe.

BATS Y Exchange will receive and review all applications for membership in the Exchange. If the Exchange is satisfied that the applicant is qualified for membership, the Exchange will promptly notify the applicant, in writing, of such determination, and the applicant shall be a member of the Exchange.<sup>71</sup> If the Exchange is not satisfied that the applicant is qualified for membership, the Exchange shall promptly notify the applicant of the grounds for denial.<sup>72</sup> Once an applicant is a member of the Exchange, it must continue to possess all the qualifications set forth in the BATS Y Exchange rules. When the Exchange has reason to believe that an Exchange member or associated person of a member fails to meet such qualifications, the Exchange may suspend or revoke such person's membership or association.<sup>73</sup>

Appeal of a staff denial, suspension, or revocation of membership will be heard by the Appeals Committee.<sup>74</sup> Decisions of the Appeals Committee will be made in writing and will be sent to the parties to the proceeding. The decisions of the Appeals Committee will be subject to review by the Exchange Board, on its own motion, or upon written request by the aggrieved party or by the Chief Regulatory Officer ("CRO"). The Exchange Board will have sole discretion to grant or deny the request. The Exchange Board will conduct the review of the Appeals Committee's decision. The Exchange Board may affirm, reverse, or modify the Appeals Committee's decision. The Exchange Board's decision is final.<sup>75</sup>

The Commission finds that the BATS Y Exchange's membership rules are consistent with Section 6 of the Act,<sup>76</sup>

specifically Section 6(b)(2) of the Act,<sup>77</sup> which requires that a national securities exchange have rules that provide that any registered broker or dealer or natural person associated with such broker or dealer may become a member and any person may become associated with an exchange member. The Commission notes that pursuant to Section 6(c) of the Act, an exchange must deny membership to any person, other than a natural person, that is not a registered broker or dealer, any natural person that is not, or is not associated with, a registered broker or dealer, and registered broker-dealers that do not satisfy certain standards, such as financial responsibility or operational capacity. As a registered exchange, BATS Y Exchange must independently determine if an applicant satisfies the standards set forth in the Act, regardless of whether an applicant is a member of another SRO.<sup>78</sup>

## 2. Regulatory Independence

BATS Y Exchange has proposed several measures to help ensure the independence of its regulatory function from its market operations and other commercial interests. The regulatory operations of BATS Y Exchange will be supervised by the CRO and monitored by the Regulatory Oversight Committee. The Regulatory Oversight Committee will consist of three members, each of whom must be a Non-Industry Director.<sup>79</sup> The Regulatory Oversight Committee will be responsible for monitoring the adequacy and effectiveness of the Exchange's regulatory program, assessing the Exchange's regulatory performance, and assisting the Exchange Board in reviewing the Exchange's regulatory plan and the overall effectiveness of the Exchange's regulatory functions.<sup>80</sup> The Regulatory Oversight Committee also will meet with the CRO in executive session at regularly scheduled meetings and at any time upon request of the CRO or any member of the Regulatory Oversight Committee.<sup>81</sup>

BATS Y Exchange proposes that its CRO have general supervision of the regulatory operations of the Exchange, including overseeing surveillance, examination, and enforcement functions.<sup>82</sup> The CRO also will

administer any regulatory services agreement with another SRO to which BATS Y Exchange is a party.<sup>83</sup> The CRO will be an Executive Vice President or Senior Vice President that reports directly to the Chief Executive Officer.<sup>84</sup> The CRO also may serve as BATS Y Exchange's General Counsel.<sup>85</sup>

In addition, BATS Y Exchange has taken steps designed to provide sufficient funding for the Exchange to carry out its responsibilities under the Act. Specifically, BATS Y Exchange has represented that: (1) BATS Global Markets will allocate sufficient operational assets and make a capital contribution to the Exchange's capital account prior to the launch of the Exchange; (2) such an allocation and contribution will be adequate to operate the Exchange, including the regulation of the Exchange; and (3) there will be an explicit agreement between the Exchange and BATS Global Markets that requires BATS Global Markets to provide adequate funding for BATS Y Exchange's operations, including the regulation of the Exchange.<sup>86</sup> In addition, any revenues received by BATS Y Exchange from fees derived from its regulatory function or regulatory penalties will not be used for non-regulatory purposes.<sup>87</sup>

## 3. Regulatory Contract

Although BATS Y Exchange will be an SRO with all of the attendant regulatory obligations under the Act, it has entered into a regulatory services agreement with FINRA ("Regulatory Contract"), under which FINRA will perform certain regulatory functions on BATS Y Exchange's behalf.<sup>88</sup> Specifically, BATS Y Exchange represents that FINRA will assist Exchange staff on registration issues on an as-needed basis, investigate potential violations of BATS Y Exchange's rules or federal securities laws related to activity on the Exchange, conduct examinations related to market conduct on the Exchange by Members, assist the Exchange with disciplinary proceedings pursuant to BATS Y Exchange's Rules, including issuing charges and conducting hearings, and provide

<sup>69</sup> *Id.*

<sup>70</sup> See BATS Y Exchange Rule 2.6.

<sup>71</sup> See BATS Y Exchange Rule 2.6(c).

<sup>72</sup> See BATS Y Exchange Rule 2.6(d).

<sup>73</sup> See BATS Y Exchange Rule 2.7; see also BATS Y Exchange Rules Chapters VII and VIII.

<sup>74</sup> See BATS Y Exchange Rule 10.3; see also BATS Y Exchange proposed Amended and Restated By-Laws Article V, Section 6(d).

<sup>75</sup> See BATS Y Exchange Rule 10.5(b).

Membership decisions are subject to review by the Commission. See BATS Y Exchange Rule 10.7.

<sup>76</sup> 15 U.S.C. 78f.

<sup>77</sup> 15 U.S.C. 78f(b)(2).

<sup>78</sup> See Nasdaq Exchange Registration Order, *supra* note 27.

<sup>79</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Articles I(v) and V, Section 6(c).

<sup>80</sup> See BATS Exchange Amended and Restated By-Laws Article V, Section 6(c).

<sup>81</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article VII, Section 9.

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> *Id.* See also Nasdaq Exchange Registration Order, *supra* note 27.

<sup>86</sup> See Amendment No. 1.

<sup>87</sup> See BATS Y Exchange proposed Amended and Restated By-Laws Article X, Section 4.

<sup>88</sup> See BATS Y Exchange Rule 13.7; see also Amendment No. 1. Pursuant to the applicable provisions of the Freedom of Information Act, 5 U.S.C. 552, and Commission regulations thereunder, 17 CFR 200.83, BATS Y Exchange has requested confidential treatment for the Regulatory Contract.

dispute resolution services to BATS Y Exchange Members on behalf of the Exchange, including operation of the Exchange's arbitration program. BATS Y Exchange represents that FINRA also will provide the Exchange with access to FINRA's WebCRD system, and will assist with programming BATS Y-specific functionality relating to such system.<sup>89</sup> Notwithstanding the Regulatory Contract, BATS Y Exchange will retain ultimate legal responsibility for the regulation of its members and its market.

The Commission believes that it is consistent with the Act to allow BATS Y Exchange to contract with FINRA to perform examination, enforcement, and disciplinary functions.<sup>90</sup> These functions are fundamental elements to a regulatory program, and constitute core self-regulatory functions. The Commission believes that FINRA has the expertise and experience to perform these functions on behalf of BATS Y Exchange.<sup>91</sup>

At the same time, BATS Y Exchange, unless relieved by the Commission of its responsibility,<sup>92</sup> bears the responsibility for self-regulatory conduct and primary liability for self-regulatory failures, not the SRO retained to perform regulatory functions on the Exchange's behalf. In performing these regulatory functions, however, FINRA may nonetheless bear liability for causing or aiding and abetting the failure of BATS Y Exchange to perform its regulatory functions.<sup>93</sup>

<sup>89</sup> See Amendment No. 1.

<sup>90</sup> See, e.g., Regulation ATS Release, *supra* note 52. See also Securities Exchange Act Release Nos. 50122 (July 29, 2004), 69 FR 47962 (August 6, 2004) (SR-Amex-2004-32) (order approving rule that allowed Amex to contract with another SRO for regulatory services) ("Amex Regulatory Services Approval Order"); 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (SR-NASDAQ-2007-004) ("NOM Approval Order"); Nasdaq Exchange Registration Order, *supra* note 27; BATS Exchange Order, *supra* note 18; and EDGX and EDGA Exchange Order, *supra* note 18.

<sup>91</sup> See, e.g., Amex Regulatory Services Approval Order, *supra* note 90; NOM Approval Order, *supra* note 90; and Nasdaq Exchange Registration Order, *supra* note 27. The Commission notes that the Regulatory Contract is not before the Commission and, therefore, the Commission is not acting on it.

<sup>92</sup> See Section 17(d)(1) of the Act and Rule 17d-2 thereunder, 15 U.S.C. 78q(d)(1) and 17 CFR 240.17d-2. See also *infra* notes 95-103 and accompanying text.

<sup>93</sup> For example, if failings by FINRA have the effect of leaving BATS Y Exchange in violation of any aspect of BATS Y Exchange's self-regulatory obligations, BATS Y Exchange would bear direct liability for the violation, while FINRA may bear liability for causing or aiding and abetting the violation. See, e.g., Nasdaq Exchange Registration Order, *supra* note 27; BATS Exchange Order, *supra* note 18; EDGX and EDGA Exchange Order, *supra* note 18; and Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) (File No. 10-127) (order approving the International Securities Exchange LLC's application for registration as a national securities exchange).

Accordingly, although FINRA will not act on its own behalf under its SRO responsibilities in carrying out these regulatory services for BATS Y Exchange, FINRA may have secondary liability if, for example, the Commission finds that the contracted functions are being performed so inadequately as to cause a violation of the federal securities laws by BATS Y Exchange.<sup>94</sup>

#### 4. 17d-2 Agreement

Section 19(g)(1) of the Act<sup>95</sup> requires every SRO to examine its members and persons associated with its members and to enforce compliance with the federal securities laws and the SRO's own rules, unless the SRO is relieved of this responsibility pursuant to Section 17(d) of the Act.<sup>96</sup> Section 17(d) was intended, in part, to eliminate unnecessary multiple examinations and regulatory duplication with respect to members of more than one SRO ("common members").<sup>97</sup> Rule 17d-2 of the Act permits SROs to propose joint plans allocating regulatory responsibilities concerning common members.<sup>98</sup> These agreements, which must be filed with and approved by the Commission, generally cover such regulatory functions as personnel registration, branch office examinations, and sales practices. Commission approval of a 17d-2 plan relieves the specified SRO of those regulatory responsibilities allocated by the plan to another SRO.<sup>99</sup> Many existing SROs have entered in to such agreements.<sup>100</sup>

BATS Y Exchange has represented to the Commission that BATS Y Exchange and FINRA intend to file a 17d-2 agreement with the Commission covering common members of BATS Y Exchange and FINRA. This agreement would allocate to FINRA regulatory

<sup>94</sup> *Id.*

<sup>95</sup> 15 U.S.C. 78s(g)(1).

<sup>96</sup> 15 U.S.C. 78q(d).

<sup>97</sup> See Securities Exchange Act Release No. 12935 (October 28, 1976), 41 FR 49091 (November 8, 1976) ("Rule 17d-2 Adopting Release").

<sup>98</sup> 17 CFR 240.17d-2.

<sup>99</sup> See Rule 17d-2 Adopting Release, *supra* note 97.

<sup>100</sup> See, e.g., Securities Exchange Act Release Nos. 13326 (March 3, 1977), 42 FR 13878 (March 14, 1977) (NYSE/Amex); 13536 (May 12, 1977), 42 FR 26264 (May 23, 1977) (NYSE/BSE); 14152 (November 9, 1977), 42 FR 59339 (November 16, 1977) (NYSE/CSE); 13535 (May 12, 1977), 42 FR 26269 (May 23, 1977) (NYSE/CHX); 13531 (May 12, 1977), 42 FR 26273 (May 23, 1977) (NYSE/PSE); 14093 (October 25, 1977), 42 FR 57199 (November 1, 1977) (NYSE/Phlx); 15191 (September 26, 1978), 43 FR 46093 (October 5, 1978) (NASD/BSE, CSE, CHX and PSE); 16858 (May 30, 1980), 45 FR 37927 (June 5, 1980) (NASD/BSE, CSE, CHX and PSE); 42815 (May 23, 2000), 65 FR 34762 (May 31, 2000) (NASD/ISE); and 54136 (July 12, 2006), 71 FR 40759 (July 18, 2006) (NASD/Nasdaq).

responsibility, with respect to common members, for the following:<sup>101</sup>

- FINRA will examine common members of BATS Y Exchange and FINRA for compliance with federal securities laws, rules and regulations, and rules of BATS Y Exchange that have been certified by BATS Y Exchange as identical or substantially similar to FINRA rules.

- FINRA will investigate common members of BATS Y Exchange and FINRA for violations of federal securities laws, rules or regulations, or BATS Y Exchange rules that has been certified by BATS Y Exchange as identical or substantially identical to a FINRA rule.

- FINRA will enforce compliance by common members with federal securities laws, rules and regulations, and rules of BATS Y Exchange that have been certified by BATS Y Exchange as identical or substantially similar to FINRA rules.

Because BATS Y Exchange anticipates entering into this 17d-2 agreement, it has not made provision to fulfill the regulatory obligations that would be undertaken by FINRA under this agreement with respect to common members of BATS Y Exchange and FINRA.<sup>102</sup> Accordingly, the Commission is conditioning the operation of BATS Y Exchange on approval by the Commission of a 17d-2 agreement between BATS Y Exchange and FINRA that allocates the above specified matters to FINRA.<sup>103</sup>

#### 5. Discipline and Oversight of Members

As noted above, a prerequisite for the Commission approval of an exchange's application for registration, an exchange must be organized and have the capacity to carry out the purposes of the Act. Specifically, an exchange must be able to enforce compliance by its members and persons associated with its members with federal securities laws and the rules of the exchange.<sup>104</sup> As noted above, pursuant to the Regulatory Contract, FINRA will perform many of the initial disciplinary processes on behalf of BATS Y Exchange.<sup>105</sup> For example, FINRA will investigate potential securities laws violations, issue complaints, and conduct hearings

<sup>101</sup> See Amendment No. 1.

<sup>102</sup> The Commission notes that regulation that is to be covered by the 17d-2 agreement for common members will be carried out by FINRA under the Regulatory Contract for BATS Y Exchange members that are not also members of FINRA.

<sup>103</sup> Alternatively, BATS Y Exchange could demonstrate that it has the ability to fulfill its regulatory obligations.

<sup>104</sup> See 15 U.S.C. 78f(b)(1).

<sup>105</sup> See *supra* note 90 and accompanying text.



pursuant to BATS Y Exchange rules. Appeals from disciplinary decisions will be heard by the Appeals Committee<sup>106</sup> and the Appeals Committee's decision shall be final. In addition, the Exchange Board may on its own initiative order review of a disciplinary decision.<sup>107</sup>

The BATS Y Exchange proposed Amended and Restated By-Laws and BATS Y Exchange rules provide that the Exchange has disciplinary jurisdiction over its members so that it can enforce its members' compliance with its rules and the federal securities laws.<sup>108</sup> The Exchange's rules also permit it to sanction members for violations of its rules and violations of the federal securities laws by, among other things, expelling or suspending members, limiting members' activities, functions, or operations, fining or censuring members, or suspending or barring a person from being associated with a member, or any other fitting sanction.<sup>109</sup> BATS Y Exchange's rules also provide for the imposition of fines for certain minor rule violations in lieu of commencing disciplinary proceedings.<sup>110</sup> Accordingly, as a condition to the operation of BATS Y Exchange, a Minor Rule Violation Plan ("MRVP") filed by BATS Y Exchange under Act Rule 19d-1(c)(2) must be declared effective by the Commission.<sup>111</sup>

The Commission finds that the BATS Y Exchange's proposed Amended and Restated By-Laws and rules concerning its disciplinary and oversight programs are consistent with the requirements of Sections 6(b)(6) and 6(b)(7)<sup>112</sup> of the Act in that they provide fair procedures for the disciplining of members and persons associated with members. The Commission further finds that the rules of BATS Y Exchange provide it with the ability to comply, and with the authority to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of BATS Y Exchange.<sup>113</sup>

### C. BATS Y Exchange Trading System

#### 1. Trading Rules

BATS Y Exchange will operate a fully automated electronic order book. Exchange members and entities that enter into sponsorship arrangements with Exchange members will have access to the BATS Y Exchange system (collectively, "Users").<sup>114</sup> Users will be able to electronically submit market and various types of limit orders to the Exchange from remote locations. BATS Y Exchange will not have a trading floor, but will allow firms to register as market makers with affirmative and negative market making obligations.<sup>115</sup> All orders submitted to BATS Y Exchange will be displayed unless designated otherwise by the BATS Y Exchange member submitting the order. Displayed orders will be displayed on an anonymous basis at a specified price. Non-displayed orders will not be displayed but will be ranked in the BATS Y Exchange system at a specified price. The BATS Y Exchange system will continuously and automatically match orders pursuant to price/time priority, except that displayed orders will have priority over non-displayed orders at the same price.<sup>116</sup>

The BATS Y Exchange system is designed to comply with Rule 611 of Regulation NMS<sup>117</sup> by requiring that, for any execution to occur on the Exchange during regular trading hours, the price must be equal to, or better than, any "protected quotation" within the meaning of Regulation NMS ("Protected Quotation"), unless an exception to Rule 611 of Regulation NMS applies.<sup>118</sup> BATS Y Exchange will direct any orders or portion of orders that cannot be executed in their entirety to away markets for execution through BATS Trading, unless the terms of the orders direct the Exchange not to route such orders away.<sup>119</sup>

BATS Y Exchange intends to operate as an automated trading center in compliance with Rule 600(b)(4) of Regulation NMS.<sup>120</sup> BATS Y Exchange will display automated quotations at all times except in the event that a systems

malfunction renders the system incapable of displaying automated quotations.<sup>121</sup> The Exchange has designed its rules relating to orders, modifiers, and order execution to comply with the requirements of Regulation NMS, including an immediate-or-cancel functionality.<sup>122</sup> These proposed rules include accepting orders marked as intermarket sweep orders, which will allow orders so designated to be automatically matched and executed without reference to Protected Quotations at other trading centers,<sup>123</sup> and routing orders marked as intermarket sweep orders by a User to a specific trading center for execution.<sup>124</sup> In addition, BATS Y Exchange rules address locked and crossed markets,<sup>125</sup> as required by Rule 610(d) of Regulation NMS.<sup>126</sup> The Commission believes that BATS Y Exchange's rules are consistent with the Act, in particular with the requirements of Rule 610(d) and Rule 611 of Regulation NMS.

As stated above, BATS Y Exchange intends to operate as an automated trading center and have its best bid and best offer be a Protected Quotation.<sup>127</sup> To meet their regulatory responsibilities under Rule 611(a) of Regulation NMS, market participants must have sufficient notice of new Protected Quotations, as well as all necessary information (such as final technical specifications).<sup>128</sup> Therefore, the Commission believes that it would be a reasonable policy and procedure under Rule 611(a) for industry participants to begin treating BATS Y Exchange's best bid and best offer as a Protected Quotation within 90 days after the date of this order, or such later date as BATS Y Exchange begins operation as a national securities exchange.

#### 2. Section 11 of the Act

Section 11(a)(1) of the Act<sup>129</sup> prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person

<sup>114</sup> To obtain authorized access to the BATS Y Exchange System, each User must enter in to a User Agreement with the Exchange. See BATS Y Exchange Rule 11.3(a).

<sup>115</sup> See BATS Y Exchange Rules 11.5 through 11.8. BATS Y Exchange's rules relating to maker makers are consistent with the rules of other national securities exchanges. See, e.g., BATS Exchange Rules 11.5 through 11.8; and National Stock Exchange, Inc. Rules 11.5 through 11.8.

<sup>116</sup> See BATS Y Exchange Rule 11.12.

<sup>117</sup> 17 CFR 242.611.

<sup>118</sup> See BATS Y Exchange Rule 11.13.

<sup>119</sup> See BATS Y Exchange Rule 11.13(a)(2).

<sup>120</sup> 17 CFR 242.600(b)(4).

<sup>121</sup> See BATS Y Exchange Rule 11.13(c); see also 17 CFR 242.600(b)(3).

<sup>122</sup> See BATS Y Exchange Rules 11.9 and 11.13; see also 17 CFR 242.600(b)(3).

<sup>123</sup> See BATS Y Exchange Rule 11.9(d)(1).

<sup>124</sup> See BATS Y Exchange Rule 11.9(d)(2).

<sup>125</sup> See BATS Y Exchange Rule 11.20.

<sup>126</sup> 17 CFR 242.610(d).

<sup>127</sup> 17 CFR 242.600(b)(58).

<sup>128</sup> See Securities Exchange Act Release No. 53829 (May 18, 2006), 71 FR 30038, 30041 (May 24, 2006) (File No. S7-10-04) (extending the compliance dates for Rule 610 and Rule 611 of Regulation NMS under the Act).

<sup>129</sup> 15 U.S.C. 78k(a)(1).

<sup>106</sup> See BATS Y Exchange Rule 8.10(b).

<sup>107</sup> See BATS Y Exchange Rule 8.10(c).

<sup>108</sup> See generally BATS Y Exchange proposed Amended and Restated By-Laws Article X and BATS Y Exchange Rules Chapters II and VIII.

<sup>109</sup> See BATS Y Exchange Rules 2.2 and 8.1(a).

<sup>110</sup> See BATS Y Exchange Rule 8.15.

<sup>111</sup> 17 CFR 240.19d-1(c)(2).

<sup>112</sup> 15 U.S.C. 78f(b)(6) and (b)(7).

<sup>113</sup> See Section 6(b)(1) of the Act, 15 U.S.C. 78f(b)(1).

exercises discretion (collectively, “covered accounts”) unless an exception applies. Rule 11a2–2(T) under the Act,<sup>130</sup> known as the “effect versus execute” rule, provides exchange members with an exemption from the Section 11(a)(1) prohibition. Rule 11a2–2(T) permits an exchange member, subject to certain conditions, to effect transactions for covered accounts by arranging for an unaffiliated member to execute the transactions on the exchange. To comply with Rule 11a2–2(T)’s conditions, a member: (i) Must transmit the order from off the exchange floor; (ii) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution;<sup>131</sup> (iii) may not be affiliated with the executing member; and (iv) with respect to an account over which the member has investment discretion, neither the member nor its associated person may retain any compensation in connection with effecting the transaction except as provided in the Rule.

In a letter to the Commission, BATS Y Exchange requested that the Commission concur with BATS Y Exchange’s conclusion that BATS Y Exchange members that enter orders into the BATS Y Exchange system satisfy the requirements of Rule 11a2–2(T).<sup>132</sup> For reasons set forth below, the Commission believes that BATS Y Exchange members entering orders into the BATS Y Exchange system would satisfy the conditions of the Rule.

The Rule’s first condition is that orders for covered accounts be transmitted from off the exchange floor. The BATS Y Exchange system receives orders electronically through remote terminals or computer-to-computer interfaces. In the context of other automated trading systems, the Commission has found that the off-floor transmission requirement is met if a covered account order is transmitted from a remote location directly to an exchange’s floor by electronic means.<sup>133</sup>

<sup>130</sup> 17 CFR 240.11a2–2(T).

<sup>131</sup> The member may, however, participate in clearing and settling the transaction.

<sup>132</sup> See to Elizabeth M. Murphy, Secretary, Commission, from Anders Franzon, Vice President and Associate General Counsel, BATS Exchange, Inc., dated June 30, 2010 (“BATS Y Exchange 11(a) Letter”).

<sup>133</sup> See, e.g., Securities Exchange Act Release Nos. 59154 (December 23, 2008) 73 FR 80468 (December 31, 2008) (SR–BSE–2008–48) (order approving proposed rules of NASDAQ OMX BX); 49068 (January 13, 2004), 69 FR 2775 (January 20, 2004) (order approving the Boston Options Exchange as an options trading facility of the Boston Stock Exchange); 44983 (October 25, 2001), 66 FR 55225 (November 1, 2001) (order approving Archipelago Exchange as electronic trading facility of the Pacific

Since the BATS Y Exchange system receives orders electronically through remote terminals or computer-to-computer interfaces, the Commission believes that the BATS Y Exchange system satisfies the off-floor transmission requirement.

Second, the rule requires that the member not participate in the execution of its order. BATS Y Exchange represented that at no time following the submission of an order is a member able to acquire control or influence over the result or timing of an order’s execution.<sup>134</sup> According to BATS Y Exchange, the execution of a member’s order is determined solely by what orders, bids, or offers are present in the system at the time the member submits the order. Accordingly, the Commission believes that a BATS Y Exchange member would not participate in the execution of an order submitted into the BATS Y Exchange system.

Third, Rule 11a2–2(T) requires that the order be executed by an exchange member who is unaffiliated with the member initiating the order. The Commission has stated that this requirement is satisfied when automated exchange facilities, such as the BATS Y Exchange system, are used, as long as the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange.<sup>135</sup>

Exchange (“PCX”) (“ArcaEx Order”); 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (regarding NYSE’s Off-Hours Trading Facility); 15533 (January 29, 1979), 44 FR 6084 (January 31, 1979) (regarding the American Stock Exchange (“Amex”) Post Execution Reporting System, the Amex Switching System, the Intermarket Trading System, the Multiple Dealer Trading Facility of the Cincinnati Stock Exchange, the PCX Communications and Execution System, and the Philadelphia Stock Exchange’s (“Phlx”) Automated Communications and Execution System (“1979 Release”)); and 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978) (regarding the NYSE’s Designated Order Turnaround System (“1978 Release”).

<sup>134</sup> See BATS Y Exchange 11(a) Letter, *supra* note 132. The member may cancel or modify the order, or modify the instructions for executing the order, but only from off the Exchange floor. *Id.* The Commission has stated that the non-participation requirement is satisfied under such circumstances so long as such modifications or cancellations are also transmitted from off the floor. See Securities Exchange Act Release No. 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978) (stating that the “non-participation requirement does not prevent initiating members from canceling or modifying orders (or the instructions pursuant to which the initiating member wishes orders to be executed) after the orders have been transmitted to the executing member, provided that any such instructions are also transmitted from off the floor”).

<sup>135</sup> In considering the operation of automated execution systems operated by an exchange, the Commission noted that while there is no independent executing exchange member, the execution of an order is automatic once it has been transmitted into the systems. Because the design of

BATS Y Exchange has represented that the design of the BATS Y Exchange system ensures that no member has any special or unique trading advantage in the handling of its orders after transmitting its orders to BATS Y Exchange.<sup>136</sup> Based on BATS Y Exchange’s representation, the Commission believes that the BATS Y Exchange system satisfies this requirement.

Fourth, in the case of a transaction effected for an account with respect to which the initiating member or an associated person thereof exercises investment discretion, neither the initiating member nor any associated person thereof may retain any compensation in connection with effecting the transaction, unless the person authorized to transact business for the account has expressly provided otherwise by written contract referring to Section 11(a) of the Act and Rule 11a2–2(T).<sup>137</sup> BATS Y Exchange represented that BATS Y Exchange members trading for covered accounts over which they exercise investment discretion must comply with this condition in order to rely on the rule’s exemption.<sup>138</sup>

#### D. Section 11A of the Act

Section 11A of the Act and the rules thereunder form the basis of our national market system and impose requirements on exchanges to implement its objectives. Specifically, national securities exchanges are required, under Rule 601 of Regulation NMS,<sup>139</sup> to file transaction reporting plans regarding transactions in listed equity and Nasdaq securities that are

these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange, the Commission has stated that executions obtained through these systems satisfy the independent execution requirement of Rule 11a2–2(T). See 1979 Release, *supra* note 133.

<sup>136</sup> See BATS Y Exchange 11(a) Letter, *supra* note 132.

<sup>137</sup> 17 CFR 240.11a2–2(T)(a)(2)(iv). In addition, Rule 11a2–2(T)(d) requires a member or associated person authorized by written contract to retain compensation, in connection with effecting transactions for covered accounts over which such member or associated person thereof exercises investment discretion, to furnish at least annually to the person authorized to transact business for the account a statement setting forth the total amount of compensation retained by the member in connection with effecting transactions for the account during the period covered by the statement. See 17 CFR 240.11a2–2(T)(d). See also 1978 Release, *supra* note 133 (stating “[t]he contractual and disclosure requirements are designed to assure that accounts electing to permit transaction-related compensation do so only after deciding that such arrangements are suitable to their interests”).

<sup>138</sup> See BATS Y Exchange 11(a) Letter, *supra* note 132.

<sup>139</sup> 17 CFR 242.601.



executed on their facilities. Currently registered exchanges satisfy this requirement by participating in the Consolidated Transaction Association Plan ("CTA Plan") for listed equities and the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis ("Nasdaq UTP Plan") for Nasdaq securities.<sup>140</sup> Before BATS Y Exchange can begin operating as an exchange, it must join these plans as a participant.

National securities exchanges are required, under Rule 602 of Regulation NMS,<sup>141</sup> to collect bids, offers, quotation sizes and aggregate quotation sizes from those members who are responsible broker or dealers. National securities exchanges must then make this information available to vendors at all times when the exchange is open for trading. The current exchanges satisfy this requirement by participating in the Consolidated Quotation System Plan ("CQ Plan") for listed equity securities and the Nasdaq UTP Plan for Nasdaq securities. Before BATS Y Exchange can begin operating as an exchange it also must join the CQ Plan as a participant, in addition to the CTA Plan and the Nasdaq UTP Plan.

Finally, national securities exchanges must make available certain order execution information pursuant to Rule 605 of Regulation NMS.<sup>142</sup> Current exchanges have standardized the required disclosure mechanisms by participating in the Order Execution Quality Disclosure Plan.<sup>143</sup> BATS Y Exchange must join this plan before it begins operations as an exchange.

#### E. Order Routing

As discussed above, BATS Global Markets wholly owns BATS Y Exchange, BATS Exchange, and BATS Trading.<sup>144</sup> As such, BATS Y Exchange and BATS Exchange are affiliated with BATS Trading, which is a registered broker-dealer and member of FINRA. BATS Trading is a member of BATS

Exchange and will become a member of BATS Y Exchange.

BATS Y Exchange's proposed Rule 2.10 provides generally that, without prior Commission approval, the Exchange may not, directly or indirectly, acquire or maintain an ownership interest in a member organization of such Exchange. In addition, BATS Y Exchange's Rule 2.10 provides that, without prior Commission approval, none of the Exchange's members may be or become an affiliate of the Exchange or an affiliate of an affiliate of the Exchange. However, BATS Y Exchange proposes that its affiliate, BATS Trading, become a member of the Exchange to provide certain routing services on behalf of the Exchange. Specifically, BATS Y Exchange proposes to (1) operate BATS Trading as a facility of the Exchange to provide outbound routing services to other securities exchanges,<sup>145</sup> automated trading systems, electronic communications networks, or other broker-dealers (collectively, "Trading Centers"), and (2) receive through BATS Trading orders routed inbound to the Exchange from its affiliated exchange (*i.e.*, BATS Exchange). Accordingly, BATS Y Exchange seeks Commission approval of an exception in the Exchange's Rule 2.10 that will permit the affiliation between the Exchange and its member, BATS Trading.

Recognizing that the Commission has previously expressed concern regarding the potential for conflicts of interest in instances where a member firm is affiliated with an exchange, particularly where a member is routing orders to such affiliated exchange,<sup>146</sup> BATS Y Exchange has proposed limitations and conditions on BATS Trading's affiliation with the Exchange. Specifically, BATS Y Exchange proposes that BATS Trading operate as an affiliated outbound router on behalf of the Exchange, subject to certain conditions set forth in the Exchange's Rule 2.11; and that BATS Trading operate as an affiliated inbound router on behalf of the Exchange subject to certain conditions set forth in the Exchange's Rule 2.12.<sup>147</sup>

#### 1. BATS Trading as Outbound Router

BATS Y Exchange proposes that BATS would operate as a facility (as defined in Section 3(a)(2) of the Act) of the Exchange providing outbound

routing services from the Exchange to other Trading Centers.<sup>148</sup> BATS Trading's operation as a facility providing outbound routing services for BATS Y Exchange is subject to the conditions that:

- BATS Y Exchange regulates BATS Trading as a facility of the Exchange;
- FINRA, a self-regulatory organization unaffiliated with the Exchange or any of its affiliates, is BATS Trading's designated examining authority;
- BATS Trading will not engage in any business other than (a) its outbound router function, (b) its inbound router function as described in Exchange Rule 2.12, and (c) any other activities it may engage in as approved by the Commission;
- The use of BATS Trading for outbound routing by Exchange members is optional;
- The Exchange will establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary information between the Exchange and its facilities (including BATS Trading) and any other entity;<sup>149</sup> and
- The books, records, premises, officers, agents, directors and employees of BATS Trading as a facility of the Exchange shall be deemed to be the books, records, premises, officers, agents, directors and employees of the Exchange for purposes of, and subject to oversight pursuant to, the Act.

As a facility of BATS Y Exchange, BATS Trading will be subject to the Exchange's and the Commission's regulatory oversight, and BATS Y Exchange will be responsible for ensuring that BATS Trading's outbound routing function is operated consistent with Section 6 of the Act and the Exchange's rules. In addition, BATS Y Exchange will be required to file with the Commission proposed rule changes and fees relating to BATS Trading's outbound routing function. Any such rules and fees relating to BATS Trading's outbound router function will be subject to exchange non-discrimination requirements. The Commission notes that the proposed conditions for the operation of BATS Trading as affiliated outbound router on behalf of the Exchange are consistent with conditions the Commission has approved for other exchanges.<sup>150</sup> The

<sup>140</sup> These plans also satisfy the requirement in Rule 603 that national securities exchanges and national securities associations act jointly pursuant to an effective national market system plan to disseminate consolidated information, including a national best bid and offer, and quotations for and transactions in NMS stocks. See 17 CFR 242.603. See also Nasdaq Exchange Registration Order, *supra* note 27.

<sup>141</sup> 17 CFR 242.602.

<sup>142</sup> 17 CFR 242.605.

<sup>143</sup> See Securities Exchange Act Release No. 44177 (April 12, 2001), 66 FR 19814 (April 17, 2001).

<sup>144</sup> See *supra* Section III.A.

<sup>145</sup> Securities exchanges to which BATS Y Exchange proposes to route orders include its affiliated exchange (*i.e.*, BATS Exchange).

<sup>146</sup> See *e.g.*, Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 FR (March 6, 2006).

<sup>147</sup> See BATS Y Exchange Rules 2.11 and 2.12.

<sup>148</sup> See BATS Y Exchange Rule 2.11.

<sup>149</sup> *Id.*

<sup>150</sup> See, *e.g.*, Securities Exchange Act Release No. 59153 (December 23, 2008), 73 FR 80485 (December 31, 2008) (order approving outbound routing by broker-dealer affiliate of Nasdaq Stock Exchange);

Commission therefore finds the proposed operation of BATS Trading as an affiliated outbound router of BATS Y Exchange to be consistent with the Act.

## 2. BATS Trading as Inbound Router

BATS Y Exchange also proposes that BATS Trading, operating as a facility of the BATS Exchange, provide routing services from BATS Exchange to BATS Y Exchange (*i.e.*, “inbound” routing), subject to the following conditions and limitations:

- The Exchange enter into (1) a 17d–2 agreement with FINRA, a non-affiliated SRO,<sup>151</sup> to relieve the Exchange of regulatory responsibilities for BATS Trading with respect to rules that are common rules between the Exchange and the non-affiliated SRO, and (2) the Regulatory Contract with FINRA,<sup>152</sup> a non-affiliated SRO, to perform regulatory responsibilities for BATS Trading for unique Exchange rules.

- The Regulatory Contract requires the Exchange to provide the non-affiliated SRO with information, in an easily accessible manner, regarding all exception reports, alerts, complaints, trading errors, cancellations, investigations, and enforcement matters (collectively “Exceptions”) in which BATS Trading is identified as a participant that has potentially violated Exchange or Commission Rules, and requires that FINRA provide a report, at least quarterly, to the Exchange quantifying all Exceptions in which BATS Trading is identified as a participant that has potentially violated Exchange or Commission rules.

- BATS Y Exchange has in place a rule that requires BATS Global Market to establish and maintain procedures and internal controls reasonably designed to ensure that BATS Trading does not develop or implement changes to its system based on non-public information obtained as a result of its affiliation with the Exchange, until such information is available generally to similarly situated members of the Exchange.

- Routing of orders from BATS Trading to the Exchange, in BATS Trading’s capacity as a facility of BATS Exchange, be authorized for a pilot period of 12 months.<sup>153</sup>

Although the Commission continues to be concerned about potential unfair competition and conflicts of interest

BATS Exchange Order, *supra* note 18; and EDGX and EDGA Exchange Order, *supra* note 18.

<sup>151</sup> See *supra* Section III.B.4 for a discussion of the Rule 17d–2 agreement.

<sup>152</sup> See *supra* Section III.B.3 for a discussion of the Regulatory Contract.

<sup>153</sup> See BATS Y Exchange Rule 2.12.

between an exchange’s self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members, for the reasons discussed below, the Commission believes that it is consistent with the Act to permit BATS Trading to be affiliated with BATS Y Exchange and to provide inbound routing to BATS Y Exchange on a pilot basis, subject to the conditions described above.

BATS Y Exchange has proposed five conditions applicable to BATS Trading’s inbound routing activities, which are enumerated above. The Commission believes that these conditions mitigate its concerns about potential conflicts of interest and unfair competitive advantage. In particular, the Commission believes that FINRA’s oversight of BATS Trading,<sup>154</sup> combined with FINRA’s monitoring of BATS Trading’s compliance with the equity trading rules and quarterly reporting to the Exchange, will help to protect the independence of the Exchange’s regulatory responsibilities with respect to BATS Trading. The Commission also believes that the requirement that BATS Y Exchange establish and maintain procedures and internal controls reasonably designed to ensure that BATS Trading does not develop or implement changes to its system based on non-public information obtained as a result of its affiliation with the Exchange, until such information is available generally to similarly situated members of the Exchange, is reasonably designed to ensure that BATS Trading cannot misuse any information advantage it may have because of its affiliation with the Exchange. Furthermore, the Commission believes that BATS Y Exchange’s proposal to allow BATS Trading to route orders inbound to the Exchange from its affiliated exchange (*i.e.*, BATS Exchange), on a pilot basis, will provide BATS Y Exchange and the Commission an opportunity to assess the impact of any conflicts of interest of allowing an affiliated member of an Exchange to route orders inbound to the Exchange and whether such affiliation provides an unfair competitive advantage.

Further, the Commission notes that the proposed conditions for the operation of BATS Trading as affiliated inbound router on behalf of BATS Y Exchange are consistent with conditions the Commission has approved for other exchanges.<sup>155</sup> The Commission

<sup>154</sup> This oversight will be accomplished through the Rule 17d–2 agreement and the Regulatory Contract.

<sup>155</sup> See *e.g.*, Securities Exchange Release Nos. 60598 (September 1, 2009), 74 FR 46280 (September

therefore finds the proposed operation of BATS Trading as an affiliated inbound router of BATS Y Exchange is consistent with the Act.

## F. Listing Requirements/Unlisted Trading Privileges

BATS Y Exchange initially does not intend to list any securities. Accordingly, BATS Y Exchange has not proposed rules that would allow it to list any securities at this time.<sup>156</sup> Instead, BATS Y Exchange has proposed to trade securities pursuant to unlisted trading privileges, consistent with Section 12(f) of the Act and Rule 12f–5 thereunder. Rule 12f–5 requires an exchange that extends unlisted trading privileges to securities to have in effect a rule or rules providing for transactions in the class or type of security to which the exchange extends unlisted trading privileges.<sup>157</sup> BATS Y Exchange’s rules allow it to extend unlisted trading privileges to any security listed on another national securities exchange or with respect to which unlisted trading privileges may otherwise be extended in accordance with Section 12(f) of the Act.<sup>158</sup> BATS Y Exchange’s proposed rules provide for transactions in the class or type of security to which the exchange intends to extend unlisted trading privileges.<sup>159</sup> In addition, pursuant to its rules, BATS Y Exchange will cease trading any equity security admitted to unlisted trading privileges that is no longer listed on another national securities exchange or to which unlisted trading privileges may no longer be extended, consistent with Section 12(f). The Commission finds that these rules are consistent with the Act.

8, 2009) (SR–ISE–2009–45); 59154 (December 23, 2008) 73 FR 80468 (December 31, 2008) (SR–BSE–2008–48) (order approving proposed rulebook of NASDAQ OMX BX); 59009 (November 24, 2008), 73 FR 73363 (December 2, 2008) (order granting accelerated approval to File No. SR–NYSEALTR–2008–07); and EDGX and EDGA Exchange Order, *supra* note 18.

<sup>156</sup> BATS Y Exchange has incorporated listing standards for certain derivative securities products in its rules. However, BATS Y Exchange’s rules will prohibit BATS Y Exchange from listing any derivative security product pursuant to these listing standards until BATS Y Exchange submits a proposed rule change to the Commission to amend its listing standards to comply with Rule 10A–3 under the Act and incorporate qualitative listing criteria. See BATS Y Exchange Rule 14.1(a).

<sup>157</sup> 17 CFR 240.12f–5. See also Securities Exchange Act Release No. 35737 (April 21, 1995), 60 FR 20891 (April 28, 1995) (adopting Rule 12f–5).

<sup>158</sup> See BATS Y Exchange Rule 14.1(a).

<sup>159</sup> *Id.* BATS Y Exchange’s rules currently do not provide for the trading of options, security futures, or other similar instruments.

#### IV. Exemption From Section 19(b) of the Act With Regard to FINRA Rules Incorporated by Reference

BATS Y Exchange proposes to incorporate by reference certain FINRA rules as Exchange rules. Thus, for certain Exchange rules, Exchange members will comply with an Exchange rule by complying with the FINRA rule referenced.<sup>160</sup> In connection with its proposal to incorporate FINRA rules by reference, BATS Y Exchange requested, pursuant to Rule 240.0–12,<sup>161</sup> an exemption under Section 36 of the Act from the rule filing requirements of Section 19(b) of the Act for changes to those BATS Y Exchange rules that are effected solely by virtue of a change to a cross-referenced FINRA rule.<sup>162</sup> BATS Y Exchange proposes to incorporate by reference categories of rules (rather than individual rules within a category) that are not trading rules. BATS Y Exchange agrees to provide written notice to its members whenever a proposed rule change to a FINRA rule that is incorporated by reference is proposed.<sup>163</sup>

Using its authority under Section 36 of the Act,<sup>164</sup> the Commission previously exempted certain SROs from the requirement to file proposed rule changes under Section 19(b) of the Act.<sup>165</sup> Each such exempt SRO agreed to be governed by the incorporated rules, as amended from time to time, but is not required to file a separate proposed rule change with the Commission each time the SRO whose rules are incorporated by reference seeks to modify its rules.

In addition, each such exempt SRO incorporated by reference only regulatory rules (*i.e.*, margin, suitability, arbitration), not trading rules, and incorporated by reference whole categories of rules (*i.e.*, did not “cherry-pick” certain individual rules within a category). Each such exempt SRO had reasonable procedures in place to

<sup>160</sup> BATS Y Exchange proposes to incorporate by reference the 12000 and 13000 Series of FINRA’s NASD Manual, the NASD Code of Arbitration Procedure for Customer and Industry Disputes. See BATS Y Exchange Rule 9.1.

<sup>161</sup> See 17 CFR 240.0–12.

<sup>162</sup> See to Elizabeth M. Murphy, Secretary, Commission, from Anders Franzon, Vice President and Associate General Counsel, BATS Exchange, Inc., dated June 30, 2010.

<sup>163</sup> BATS Exchange will provide such notice via a posting on the same Web site location where BATS Exchange will post its own rule filings pursuant to Commission Rule 19b–4(J). The posting will include a link to the location on the FINRA Web site where the proposed rule change is posted. See *id.*

<sup>164</sup> 15 U.S.C. 78mm.

<sup>165</sup> See, *e.g.*, NOM Approval Order, *supra* note 90; Nasdaq Exchange Registration Order, *supra* note 27; BATS Exchange Order, *supra* note 18; and EDGX and EDGA Exchange Order, *supra* note 18.

provide written notice to its members each time a change is proposed to the incorporated rules of another SRO in order to provide its members with notice of a proposed rule change that affects their interests, so that they would have an opportunity to comment on it.

The Commission is granting BATS Y Exchange’s request for exemption, pursuant to Section 36 of the Act, from the rule filing requirements of Section 19(b) of the Act with respect to the rules that BATS Y Exchange proposes to incorporate by reference. This exemption is conditioned upon BATS Y Exchange providing written notice to its members whenever FINRA proposes to change a rule that BATS Y Exchange has incorporated by reference. The Commission believes that this exemption is appropriate in the public interest and consistent with the protection of investors because it will promote more efficient use of Commission and SRO resources by avoiding duplicative rule filings based on simultaneous changes to identical rules sought by more than one SRO. Consequently, the Commission grants BATS Y Exchange’s exemption request.

#### V. Conclusion

*It is ordered* that the application of BATS Y Exchange for registration as a national securities exchange be, and hereby is, granted.

*It is further ordered* that operation of BATS Y Exchange is conditioned on the satisfaction of the requirements below:

A. *Participation in National Market System Plans.* BATS Y Exchange must join the CTA Plan, the CQ Plan, the Nasdaq UTP Plan, and the Order Execution Quality Disclosure Plan.

B. *Intermarket Surveillance Group.* BATS Y Exchange must join the Intermarket Surveillance Group.

C. *Minor Rule Violation Plan.* A MRVP filed by BATS Y Exchange under Rule 19d–1(c)(2) must be declared effective by the Commission.<sup>166</sup>

D. *17d–2 Agreement.* An agreement pursuant to Rule 17d–2<sup>167</sup> between FINRA and BATS Y Exchange that allocates to FINRA regulatory responsibility for those matters specified above<sup>168</sup> must be approved by the Commission, or BATS Y Exchange must demonstrate that it independently has the ability to fulfill all of its regulatory obligations.

E. *Examination by the Commission.* BATS Y Exchange must have, and represent in a letter to the staff in the

Commission’s Office of Compliance Inspections and Examinations that it has, adequate procedures and programs in place to effectively regulate BATS Y Exchange.

F. *Trade Processing and Exchange Systems.* BATS Y Exchange must have, and represent in a letter to the staff in the Commission’s Division of Trading and Markets that it has, adequate procedures and programs in place, as noted in Commission Automation Policy Review guidelines,<sup>169</sup> to effectively process trades and maintain the confidentiality, integrity, and availability of the Exchange’s systems.

G. *BATS Exchange Inbound Routing.* BATS Exchange must have in place rules approved by the Commission relating to an inbound routing structure that is consistent with what the Commission has approved for other national securities exchanges that receive orders from affiliated routers.<sup>170</sup>

*It is further ordered*, pursuant to Section 36 of the Act,<sup>171</sup> that BATS Y Exchange shall be exempt from the rule filing requirements of Section 19(b) of the Act<sup>172</sup> with respect to the FINRA rules BATS Y Exchange proposes to incorporate by reference into BATS Y Exchange’s rules, subject to the conditions specified in this Order.

By the Commission.

**Florence E. Harmon,**  
Deputy Secretary.

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## COMMODITY FUTURES TRADING COMMISSION

### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–62725; File No. 4–609]

#### Joint Public Roundtable on Governance and Conflicts of Interest in the Clearing and Listing of Swaps and Security-Based Swaps

AGENCY: Commodity Futures Trading Commission (“CFTC”) and Securities

<sup>169</sup> On November 16, 1989, the Commission published its first Automation Review Policy (“ARP I”), in which it created a voluntary framework for self-regulatory organizations to establish comprehensive planning and assessment programs to determine systems capacity and vulnerability. On May 9, 1991, the Commission published its second Automation Review Policy (“ARP II”) to clarify the types of review and reports that were expected from self-regulatory organizations. See Securities Exchange Act Release Nos. 27445 (November 16, 1989), 54 FR 48703 (November 24, 1989); and 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991).

<sup>170</sup> See *supra* note 155.

<sup>171</sup> 15 U.S.C. 78mm.

<sup>172</sup> 15 U.S.C. 78s(b).

<sup>166</sup> 17 CFR 240.19d–1(c)(2).

<sup>167</sup> 17 CFR 240.17d–2.

<sup>168</sup> See *supra* notes 95 to 103 and accompanying text.