

Required fields are shown with yellow backgrounds and asterisks.

Filing by Bats EDGX Exchange, Inc.  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input type="checkbox"/>	Section 19(b)(3)(A) * <input checked="" type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
			Rule		
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input checked="" type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 806(e)(1) * <input type="checkbox"/>	Section 806(e)(2) * <input type="checkbox"/>
Section 3C(b)(2) * <input type="checkbox"/>	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

The Exchange proposes to add Interpretation and Policy .01 to Rule 16.1 to specify the manner in which the Exchange calculates average daily order submissions for purposes of counting Professional orders.

**Contact Information**

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * Anders	Last Name * Franzon
Title * SVP, Associate General Counsel	
E-mail * afranzon@bats.com	
Telephone * (913) 815-7154	Fax

**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title \*)

Date 06/30/2016	SVP, Associate General Counsel
By Anders Franzon (Name *)	



afranzon@bats.com

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

**Form 19b-4 Information \***

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act” or “Exchange Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> Bats EDGX Exchange, Inc. (“EDGX” or the “Exchange”) proposes to add Interpretation and Policy .01 to Rule 16.1 to specify the manner in which the Exchange calculates average daily order submissions for purposes of counting Professional orders, as further described below.

The text of the proposed rule change is attached as Exhibit 5. Text proposed to be added is underlined. Text proposed to be deleted is enclosed in brackets.

(b) Inapplicable.

(c) Inapplicable.

2. Procedures of the Self-Regulatory Organization

The Exchange submits the proposed rule change pursuant to authority delegated by the Board of Directors of the Exchange on February 11, 2014. Exchange staff will advise the Exchange’s Board of Directors of any action taken pursuant to delegated authority. No other action is necessary for the filing of the rule change and, therefore, the Exchange’s internal procedures with respect to the proposed change are complete.

The persons on the Exchange staff prepared to respond to questions and comments on the proposed rule change are:

Eric Swanson  
Executive Vice President and  
General Counsel  
(913) 815-7000

Anders Franzon  
SVP, Associate General Counsel  
(913) 815-7154

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

<sup>2</sup> 17 CFR 240.19b-4.

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

(a) Purpose

The Exchange proposes to add Interpretation and Policy .01 to Rule 16.1 to specify the methodology for counting average daily order submissions in listed options to determine whether a person or entity meets the definition of a Professional (“Professional order counting”). The proposed rule change is designed to harmonize Professional order counting with the recently adopted rules of competing options exchanges – specifically the Chicago Board of Options Exchange, Inc. (“CBOE”) and NASDAQ OMX PHLX LLC (“PHLX”).<sup>3</sup>

Rule 16.1(a)(46) defines a Professional “as any person or entity that (A) is not a broker or dealer in securities; and (B) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s).” In adopting Rule 16.1(a)(46), the Exchange believed that identifying Professional accounts based upon the average number of orders entered in qualified accounts is an appropriate, objective approach that will reasonably distinguish such persons and entities from non-professional, retail investors or market participants. In order to properly represent orders entered on the Exchange, Options Members are required to indicate whether Customer

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<sup>3</sup> See Securities Exchange Act Release Nos. 77450 (March 25, 2016), 81 FR 18668, (March 31, 2016) (SR-CBOE-2016-005); 77449 (March 25, 2016), 81 FR 18665, (March 31, 2016) (SR-Phlx-2016-10) (approval orders). The Exchange notes that it recently issued guidance regarding Professional order counting. See e.g., Bats BZX Exchange, Inc. and Bats EDGX Exchange Inc., Regulatory Circular (RC-2015-012, respectively) dated December 21, 2015. This proposal codifies that guidance in a manner that is consistent with CBOE and PHLX’s approved rules. The Exchange notes that various other options exchanges refer to Professionals as “Professional Customers.” The Exchange has proposed to continue to use the term Professional, as is currently the case in Exchange rules.

orders are “Professional” orders.<sup>4</sup> To comply with this requirement, Options Members are required to review their Customers’ activity on at least a quarterly basis to determine whether orders that are not for the account of a broker-dealer should be represented as Customer orders or Professional orders.<sup>5</sup>

The advent of new multi-leg spread products and the proliferation of the use of complex orders and algorithmic execution strategies by both institutional and retail market participants has raised questions as to what should be counted as an “order” for Professional order counting purposes. The proposed changes would specifically address the counting of multi-leg spread products, algorithm generated orders, and complex orders for purposes of determining Professional status. In addition, the proposal is intended to provide guidance regarding the methodology used by the Exchange when calculating average daily orders for Professional order counting purposes.<sup>6</sup>

As proposed, the rule would provide that an order would count as one order for Professional counting purposes, unless one of the exceptions enumerated in the proposed

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<sup>4</sup> See e.g., Rule 18.2(a)(6) (Conduct and Compliance with the Rules) (requiring that accurate information is input into the System, including but not limited to, the Options Member’s capacity).

<sup>5</sup> Orders for any customer that had an average of more than 390 orders per day during any month of a calendar quarter must be represented as Professional orders for the next calendar quarter. Option Members would be required to conduct a quarterly review and make any appropriate changes to the way in which they are representing orders within five business days after the end of each calendar quarter. While Option Members only would be required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a customer for which orders are being represented as Customer orders but that has averaged more than 390 orders per day during a month, the Exchange would notify the Option Member would be required to change the manner in which it is representing the customer’s orders within five business days.

<sup>6</sup> This proposal is consistent with CBOE and PHLX’s approved rules. See *supra* note 3.

rule stipulates otherwise (each an “Exception”). The first Exception relates to the treatment of complex orders for purposes of computing orders for Professional order counting purposes. Specifically, the proposed rule provides that a complex order of eight (8) option legs or less would count as one order, whereas a complex order comprised of nine (9) option legs or more counts as multiple orders with each option leg counting as its own separate order.<sup>7</sup> The Exchange believes the distinction between complex orders with up to eight option legs from those with nine or more option legs is appropriate in light of the purposes for which Rule 16.1(a)(46) was adopted. In particular, the Exchange notes that multi-leg complex order strategies with nine or more option legs are more complex in nature and thus, more likely to be used by professional traders than traditional two, three, and four option leg complex order strategies such as the strangle, straddle, butterfly, collar, and condor strategies, and combinations thereof with eight option legs or fewer, which are generally not algorithmically generated and are frequently used by non-professional, retail investors. Thus, the types of complex orders traditionally placed by retail investors would continue to count as only one order while the more complex strategy orders that are typically used by professional traders would count as multiple orders for Professional order counting purposes.<sup>8</sup>

The second Exception relates to calculations for parent/child orders. As proposed, if a parent order submitted for the beneficial account(s) of a person or entity other than a broker or dealer is subsequently broken up into multiple child orders on the same side (buy/sell) and series by a broker or dealer, or by an algorithm housed at the

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<sup>7</sup> See proposed Interpretation and Policy .01(a)(1)-(2).

<sup>8</sup> See also supra note 3.

broker or dealer, or by an algorithm licensed from the broker or dealer but housed with the customer, then the order would count as one order even if the child orders are routed across several exchanges.<sup>9</sup> The Exchange believes this proposed change would allow the orders of public customers to be “worked” by a broker (or a broker’s algorithm) in order to achieve best execution without counting the multiple child orders as separate orders for Professional order counting purposes. Conversely, if a parent order, including a strategy order,<sup>10</sup> is broken into multiple child orders on both sides (buy/sell) of a series and/or multiple series, then each child order would count as a separate new order per side and series.<sup>11</sup> This proposed change would allow the Exchange, for Professional order counting purposes, to count as multiple orders those “child” orders of “parent” orders generated by algorithms that are typically used by sophisticated traders to continuously update their orders in concert with market updates in order to keep their overall trading strategies in balance.

The third Exception would govern the counting methodology for cancel/replace orders. As proposed, any order that cancels and replaces an existing order would count as a separate order (or multiple orders in the case of complex orders of nine option legs or more) for Professional order counting purposes.<sup>12</sup> However, the Exchange proposes that an order to cancel and replace a child order would not count as a new order if the parent

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<sup>9</sup> See proposed Interpretation and Policy .01(b)(1).

<sup>10</sup> The term “strategy order” refers to an execution strategy, trading instruction, or algorithm whereby multiple “child” orders on both sides of a series and/or multiple series are generated prior to being sent to an options exchange(s).

<sup>11</sup> See proposed Interpretation and Policy .01(b)(2).

<sup>12</sup> See proposed Interpretation and Policy .01(c)(1).

order that was placed for the beneficial account(s) of a non-broker or dealer had been subsequently broken into multiple child orders on the same side and series as the parent order by a broker or dealer, algorithm at a broker or dealer, or algorithm licensed from a broker or dealer but housed at the customer.<sup>13</sup> By contrast, the Exchange proposes that an order that cancels and replaces a child order resulting from a parent order, including a strategy order, that generated child orders on both sides (buy/sell) of a series and/or in multiple series would count as a new order per side and series (“Both Sides/Multiple Series”).<sup>14</sup> Finally, the Exchange proposes that, notwithstanding the treatment of a cancel/replace relating to Same Sides/Same Series orders, an order that cancels and replaces any child order resulting from a parent order being pegged to the Exchange’s best bid or offer (“BBO”) or the national best bid or offer (“NBBO”) or that cancels and replaces any child order pursuant to an algorithm that uses the BBO or NBBO in the calculation of child orders and attempts to move with or follow the BBO or NBBO of a particular options series would count as a new order each time the order cancels and replaces in order to attempt to move with or follow the BBO or NBBO.<sup>15</sup>

### Implementation

The Exchange proposes to implement the rule on July 1, 2016, which would be announced in a circular distributed to Members.

(b) Statutory Basis

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<sup>13</sup> See proposed Interpretation and Policy .01(c)(2).

<sup>14</sup> See proposed Interpretation and Policy .01(c)(3).

<sup>15</sup> See proposed Interpretation and Policy .01(c)(4).

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>16</sup>, in general, and furthers the objectives of Section 6(b)(5),<sup>17</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, 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. Additionally, the Exchange believes the proposed rule change is consistent with the requirement set forth in Section 6(b)(5)<sup>18</sup> of the Act that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

Specifically, the Exchange believes that the proposal is designed to adopt a reasonable and objective approach to determine Professional status that is consistent with the approach being utilized on other options exchanges, which benefits market participants by providing consistency across exchanges regarding the Professional order counting.<sup>19</sup> In this regard, the Exchange believes that codifying the manner in which the Exchange would conduct Professional order counting would provide Option Members with certainty and provide them with insight as they conduct their own quarterly reviews for purposes of designating orders.

The Exchange notes that it is not amending the threshold of 390 orders in listed options per day but, consistent with other exchanges, is revising the method for counting

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<sup>16</sup> 15 U.S.C. 78f(b).

<sup>17</sup> 15 U.S.C. 78f(b)(5).

<sup>18</sup> 15 U.S.C. 78f(b)(5).

<sup>19</sup> See supra note 3.

Professional orders in the context of multi-part orders and cancel/replace activity. In short, the proposal addresses how to account for complex orders, parent/child orders, and cancel/replace orders. The Exchange believes that distinguishing between complex orders with nine or more option legs and those orders with eight or fewer option legs is a reasonable and objective approach. In addition, the Exchange believes the proposal appropriately distinguishes between parent/child orders that are generated by a broker's efforts to obtain an execution on a larger size order while minimizing market impact and multi-part orders that used by more sophisticated market participants. Similarly, the Exchange believes that the proposal that cancel/replace orders would count as separate orders with limited exceptions is a reasonable and objective approach to distinguish the orders of retail customers that are "worked" by a broker from orders generated by algorithms used by more sophisticated market participants.

In addition, the Exchange believes that proposed changes to Rule 16.1 provide a more conservative order counting regime for Professional order counting purposes that would identify more traders as Professionals to which the Exchange's definition of Professional was designed to apply and create a better competitive balance for all participants on the Exchange, consistent with the Act. As the options markets have evolved to become more electronic and more competitive, the Exchange believes that the distinction between registered broker-dealers and professional traders who are currently treated as public customers has become increasingly blurred. More and more, the category of public customer today includes sophisticated algorithmic traders including former market makers and hedge funds that trade with a frequency resembling that of broker-dealers. The Exchange believes that it is reasonable under the Act to treat those

customers who meet the high level of trading activity established in the proposal differently than customers who do not meet that threshold and are more typical retail investors to ensure that professional traders do not take advantage of priority and/or fee benefits intended for public customers. The Exchange notes that it is not unfair to differentiate between different types of investors in order to achieve certain marketplace balances. The Exchange's Rules currently differentiate between Customers, Order Entry Firms, Market Makers, and the like.

These differentiations have been recognized to be consistent with the Act. The Exchange does not believe that the rules of the Exchange or other exchanges that accord priority or fee benefits to public customers over broker-dealers are unfairly discriminatory. Nor does the Exchange believe that it is unfairly discriminatory to accord such benefits to only those public customers who on average do not place more than one order per minute (390 per day) under the counting regime that the Exchange proposes. The Exchange believes that such differentiations drive competition in the marketplace and are within the business judgment of the Exchange. Accordingly, the Exchange also believes that its proposal is consistent with the requirement of Section 6(b)(8)<sup>20</sup> of the Act that the rules of an exchange not impose an unnecessary or inappropriate burden upon competition in that it treats persons who should be deemed Professionals, but who may not be so under current Rule 16.1(a)(46), in a manner so that they do not receive special benefits. Furthermore, the Exchange believes that the proposed rule change will protect investors and the public interest by helping to assure that retail customers continue to receive the appropriate marketplace advantages on the Exchange and in the

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<sup>20</sup> 15 U.S.C. 78f(b)(8).

marketplace as intended, while furthering competition among marketplace professionals by treating them in the same manner as other similarly situated market participants. The Exchange believes that it is consistent with Section 6(b)(5)<sup>21</sup> of the Act not to afford market participants with similar access to information and technology as that of brokers and dealers of securities with marketplace advantages over such marketplace competitors. The Exchange also believes that the proposed rule change would help to remove burdens on competition and promote a more competitive marketplace by affording certain marketplace advantages only to those for whom they are intended. Finally, the Exchange believes that the proposed rule change sets forth a more detailed and clear regulatory regime with respect to calculating average daily order entry for Professional order counting purposes. The Exchange believes that this additional clarity and detail will eliminate confusion among market participants, which is in the interests of all investors and the general public.

Based on the foregoing, the Exchange believes the proposal, which establishes an objective methodology for counting average daily order submissions for Professional order counting purposes, is consistent with the Act.

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

The Exchange does not believe that its proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange believes that the proposed rule change will help ensure fairness in the marketplace and promote competition among all market participants. The Exchange believes that this proposal would help establish more competition among

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<sup>21</sup> 15 U.S.C. 78f(b)(5).

market participants and promote the purposes for which the Exchange's Professional rule was originally adopted. Moreover, the proposal would ensure consistency and help to eliminate confusion as to the manner in which options exchanges compute the Professional order volume.

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

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from Members or other interested parties.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

The Exchange has designated this rule filing as non-controversial under Section 19(b)(3)(A) of the Act<sup>22</sup> and paragraph (f)(6) of Rule 19b-4 thereunder.<sup>23</sup> The Exchange asserts that the proposed rule change: (1) will not significantly affect the protection of investors or the public interest, (2) will not impose any significant burden on competition, and (3) will not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate. In addition, the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days

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<sup>22</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>23</sup> 17 CFR 240.19b-4.

prior to the date of filing, or such shorter time as designated by the Commission.<sup>24</sup>

The Exchange notes that this proposal does not propose any new policies or provisions that are unique or unproven, but instead is based on and substantively identical to CBOE and PHLX's approved rules.<sup>25</sup> Accordingly, the Exchange has designated this rule filing as non-controversial under Section 19(b)(3)(A) of the Act<sup>26</sup> and paragraph (f)(6) of Rule 19b-4 thereunder.<sup>27</sup>

The Exchange respectfully requests that the Commission waive the 30-day operative delay so that the proposed rule change may become effective and operative upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act<sup>28</sup> and paragraph (f)(6) of Rule 19b-4 thereunder.<sup>29</sup> Waiver of the 30-day operative delay will allow the Exchange to implement the new Interpretation and Policy on July 1, 2016, which is consistent with the implementation of similar proposals by at least one other options exchange that more recently adopted a similar rule.<sup>30</sup> The Exchange believes that adopting the interpretation consistent with, and at the same time as, other options exchanges will help to eliminate confusion for options industry participants. Waiver of the operative delay is consistent with the protection of investors and the public interest

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<sup>24</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>25</sup> See supra note 3.

<sup>26</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>27</sup> 17 CFR 240.19b-4.

<sup>28</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>29</sup> 17 CFR 240.19b-4(f)(6).

<sup>30</sup> See MIAX Options Regulatory Circular – Professional Interest and Priority Customer Order Counting Methodology (June 1, 2016), *available at*: [https://www.miaxoptions.com/sites/default/files/circular-files/MIAX\\_RC\\_2016\\_17.pdf](https://www.miaxoptions.com/sites/default/files/circular-files/MIAX_RC_2016_17.pdf).

for the reasons described above.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposed amendments to Rule 16.1(a)(46) are based on and substantively identical to CBOE's Interpretation and Policy .01 to Rule 1.1(ggg) and PHLX Rule 1000(b)(14).<sup>31</sup>

9. Security Based- Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1: Form of Notice of Proposed Rule Change for the Federal Register.

Exhibits 2–4: Not applicable.

Exhibit 5: Text of the Proposed Rule Change.

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<sup>31</sup> See supra note 3.

EXHIBIT 1

## SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-\_\_\_\_\_; File No. SR-BatsEDGX-2016-28)

Self-Regulatory Organizations; Bats EDGX Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to add Interpretation and Policy .01 to Rule 16.1 to Specify the Calculation Methodology for Counting Professional Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on \_\_\_\_\_, Bats EDGX Exchange, Inc. (the “Exchange” or “EDGX”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange has designated this proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6)(iii) thereunder,<sup>4</sup> which renders it effective upon filing with the Commission. 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 add Interpretation and Policy .01 to Rule 16.1 to specify the manner in which the Exchange calculates average daily order submissions for purposes of counting Professional orders, as further described below.

The text of the proposed rule change is available at the Exchange’s website at [www.batstrading.com](http://www.batstrading.com), at the principal office of the Exchange, and at the Commission’s

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6)(iii).

Public Reference Room.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts of such statements.

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

1. Purpose

The Exchange proposes to add Interpretation and Policy .01 to Rule 16.1 to specify the methodology for counting average daily order submissions in listed options to determine whether a person or entity meets the definition of a Professional ("Professional order counting"). The proposed rule change is designed to harmonize Professional order counting with the recently adopted rules of competing options exchanges – specifically the Chicago Board of Options Exchange, Inc. ("CBOE") and NASDAQ OMX PHLX LLC ("PHLX").<sup>5</sup>

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<sup>5</sup> See Securities Exchange Act Release Nos. 77450 (March 25, 2016), 81 FR 18668, (March 31, 2016) (SR-CBOE-2016-005); 77449 (March 25, 2016), 81 FR 18665, (March 31, 2016) (SR-Phlx-2016-10) (approval orders). The Exchange notes that it recently issued guidance regarding Professional order counting. See e.g., Bats BZX Exchange, Inc. and Bats EDGX Exchange Inc., Regulatory Circular (RC-2015-012, respectively) dated December 21, 2015. This proposal codifies that guidance in a manner that is consistent with CBOE and PHLX's approved rules. The Exchange notes that various other options exchanges refer to Professionals as "Professional Customers." The Exchange has proposed to continue to use the term Professional, as is currently the case in Exchange rules.

Rule 16.1(a)(46) defines a Professional “as any person or entity that (A) is not a broker or dealer in securities; and (B) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s).” In adopting Rule 16.1(a)(46), the Exchange believed that identifying Professional accounts based upon the average number of orders entered in qualified accounts is an appropriate, objective approach that will reasonably distinguish such persons and entities from non-professional, retail investors or market participants. In order to properly represent orders entered on the Exchange, Options Members are required to indicate whether Customer orders are “Professional” orders.<sup>6</sup> To comply with this requirement, Options Members are required to review their Customers’ activity on at least a quarterly basis to determine whether orders that are not for the account of a broker-dealer should be represented as Customer orders or Professional orders.<sup>7</sup>

The advent of new multi-leg spread products and the proliferation of the use of complex orders and algorithmic execution strategies by both institutional and retail market participants has raised questions as to what should be counted as an “order” for

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<sup>6</sup> See e.g., Rule 18.2(a)(6) (Conduct and Compliance with the Rules) (requiring that accurate information is input into the System, including but not limited to, the Options Member’s capacity).

<sup>7</sup> Orders for any customer that had an average of more than 390 orders per day during any month of a calendar quarter must be represented as Professional orders for the next calendar quarter. Option Members would be required to conduct a quarterly review and make any appropriate changes to the way in which they are representing orders within five business days after the end of each calendar quarter. While Option Members only would be required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a customer for which orders are being represented as Customer orders but that has averaged more than 390 orders per day during a month, the Exchange would notify the Option Member would be required to change the manner in which it is representing the customer’s orders within five business days.

Professional order counting purposes. The proposed changes would specifically address the counting of multi-leg spread products, algorithm generated orders, and complex orders for purposes of determining Professional status. In addition, the proposal is intended to provide guidance regarding the methodology used by the Exchange when calculating average daily orders for Professional order counting purposes.<sup>8</sup>

As proposed, the rule would provide that an order would count as one order for Professional counting purposes, unless one of the exceptions enumerated in the proposed rule stipulates otherwise (each an “Exception”). The first Exception relates to the treatment of complex orders for purposes of computing orders for Professional order counting purposes. Specifically, the proposed rule provides that a complex order of eight (8) option legs or less would count as one order, whereas a complex order comprised of nine (9) option legs or more counts as multiple orders with each option leg counting as its own separate order.<sup>9</sup> The Exchange believes the distinction between complex orders with up to eight option legs from those with nine or more option legs is appropriate in light of the purposes for which Rule 16.1(a)(46) was adopted. In particular, the Exchange notes that multi-leg complex order strategies with nine or more option legs are more complex in nature and thus, more likely to be used by professional traders than traditional two, three, and four option leg complex order strategies such as the strangle, straddle, butterfly, collar, and condor strategies, and combinations thereof with eight option legs or fewer, which are generally not algorithmically generated and are frequently used by non-

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<sup>8</sup> This proposal is consistent with CBOE and PHLX’s approved rules. See supra note 5.

<sup>9</sup> See proposed Interpretation and Policy .01(a)(1)-(2).

professional, retail investors. Thus, the types of complex orders traditionally placed by retail investors would continue to count as only one order while the more complex strategy orders that are typically used by professional traders would count as multiple orders for Professional order counting purposes.<sup>10</sup>

The second Exception relates to calculations for parent/child orders. As proposed, if a parent order submitted for the beneficial account(s) of a person or entity other than a broker or dealer is subsequently broken up into multiple child orders on the same side (buy/sell) and series by a broker or dealer, or by an algorithm housed at the broker or dealer, or by an algorithm licensed from the broker or dealer but housed with the customer, then the order would count as one order even if the child orders are routed across several exchanges.<sup>11</sup> The Exchange believes this proposed change would allow the orders of public customers to be “worked” by a broker (or a broker’s algorithm) in order to achieve best execution without counting the multiple child orders as separate orders for Professional order counting purposes. Conversely, if a parent order, including a strategy order,<sup>12</sup> is broken into multiple child orders on both sides (buy/sell) of a series and/or multiple series, then each child order would count as a separate new order per side and series.<sup>13</sup> This proposed change would allow the Exchange, for Professional order counting purposes, to count as multiple orders those “child” orders of “parent” orders generated by algorithms that are typically used by sophisticated traders to continuously

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<sup>10</sup> See also supra note 5.

<sup>11</sup> See proposed Interpretation and Policy .01(b)(1).

<sup>12</sup> The term “strategy order” refers to an execution strategy, trading instruction, or algorithm whereby multiple “child” orders on both sides of a series and/or multiple series are generated prior to being sent to an options exchange(s).

<sup>13</sup> See proposed Interpretation and Policy .01(b)(2).

update their orders in concert with market updates in order to keep their overall trading strategies in balance.

The third Exception would govern the counting methodology for cancel/replace orders. As proposed, any order that cancels and replaces an existing order would count as a separate order (or multiple orders in the case of complex orders of nine option legs or more) for Professional order counting purposes.<sup>14</sup> However, the Exchange proposes that an order to cancel and replace a child order would not count as a new order if the parent order that was placed for the beneficial account(s) of a non-broker or dealer had been subsequently broken into multiple child orders on the same side and series as the parent order by a broker or dealer, algorithm at a broker or dealer, or algorithm licensed from a broker or dealer but housed at the customer.<sup>15</sup> By contrast, the Exchange proposes that an order that cancels and replaces a child order resulting from a parent order, including a strategy order, that generated child orders on both sides (buy/sell) of a series and/or in multiple series would count as a new order per side and series (“Both Sides/Multiple Series”).<sup>16</sup> Finally, the Exchange proposes that, notwithstanding the treatment of a cancel/replace relating to Same Sides/Same Series orders, an order that cancels and replaces any child order resulting from a parent order being pegged to the Exchange’s best bid or offer (“BBO”) or the national best bid or offer (“NBBO”) or that cancels and replaces any child order pursuant to an algorithm that uses the BBO or NBBO in the calculation of child orders and attempts to move with or follow the BBO or NBBO of a

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<sup>14</sup> See proposed Interpretation and Policy .01(c)(1).

<sup>15</sup> See proposed Interpretation and Policy .01(c)(2).

<sup>16</sup> See proposed Interpretation and Policy .01(c)(3).

particular options series would count as a new order each time the order cancels and replaces in order to attempt to move with or follow the BBO or NBBO.<sup>17</sup>

### Implementation

The Exchange proposes to implement the rule on July 1, 2016, which would be announced in a circular distributed to Members.

#### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>18</sup>, in general, and furthers the objectives of Section 6(b)(5),<sup>19</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, 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. Additionally, the Exchange believes the proposed rule change is consistent with the requirement set forth in Section 6(b)(5)<sup>20</sup> of the Act that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

Specifically, the Exchange believes that the proposal is designed to adopt a reasonable and objective approach to determine Professional status that is consistent with the approach being utilized on other options exchanges, which benefits market participants by providing consistency across exchanges regarding the Professional order

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<sup>17</sup> See proposed Interpretation and Policy .01(c)(4).

<sup>18</sup> 15 U.S.C. 78f(b).

<sup>19</sup> 15 U.S.C. 78f(b)(5).

<sup>20</sup> 15 U.S.C. 78f(b)(5).

counting.<sup>21</sup> In this regard, the Exchange believes that codifying the manner in which the Exchange would conduct Professional order counting would provide Option Members with certainty and provide them with insight as they conduct their own quarterly reviews for purposes of designating orders.

The Exchange notes that it is not amending the threshold of 390 orders in listed options per day but, consistent with other exchanges, is revising the method for counting Professional orders in the context of multi-part orders and cancel/replace activity. In short, the proposal addresses how to account for complex orders, parent/child orders, and cancel/replace orders. The Exchange believes that distinguishing between complex orders with nine or more option legs and those orders with eight or fewer option legs is a reasonable and objective approach. In addition, the Exchange believes the proposal appropriately distinguishes between parent/child orders that are generated by a broker's efforts to obtain an execution on a larger size order while minimizing market impact and multi-part orders that used by more sophisticated market participants. Similarly, the Exchange believes that the proposal that cancel/replace orders would count as separate orders with limited exceptions is a reasonable and objective approach to distinguish the orders of retail customers that are "worked" by a broker from orders generated by algorithms used by more sophisticated market participants.

In addition, the Exchange believes that proposed changes to Rule 16.1 provide a more conservative order counting regime for Professional order counting purposes that would identify more traders as Professionals to which the Exchange's definition of Professional was designed to apply and create a better competitive balance for all

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<sup>21</sup> See supra note 5.

participants on the Exchange, consistent with the Act. As the options markets have evolved to become more electronic and more competitive, the Exchange believes that the distinction between registered broker-dealers and professional traders who are currently treated as public customers has become increasingly blurred. More and more, the category of public customer today includes sophisticated algorithmic traders including former market makers and hedge funds that trade with a frequency resembling that of broker-dealers. The Exchange believes that it is reasonable under the Act to treat those customers who meet the high level of trading activity established in the proposal differently than customers who do not meet that threshold and are more typical retail investors to ensure that professional traders do not take advantage of priority and/or fee benefits intended for public customers. The Exchange notes that it is not unfair to differentiate between different types of investors in order to achieve certain marketplace balances. The Exchange's Rules currently differentiate between Customers, Order Entry Firms, Market Makers, and the like.

These differentiations have been recognized to be consistent with the Act. The Exchange does not believe that the rules of the Exchange or other exchanges that accord priority or fee benefits to public customers over broker-dealers are unfairly discriminatory. Nor does the Exchange believe that it is unfairly discriminatory to accord such benefits to only those public customers who on average do not place more than one order per minute (390 per day) under the counting regime that the Exchange proposes. The Exchange believes that such differentiations drive competition in the marketplace and are within the business judgment of the Exchange. Accordingly, the Exchange also

believes that its proposal is consistent with the requirement of Section 6(b)(8)<sup>22</sup> of the Act that the rules of an exchange not impose an unnecessary or inappropriate burden upon competition in that it treats persons who should be deemed Professionals, but who may not be so under current Rule 16.1(a)(46), in a manner so that they do not receive special benefits. Furthermore, the Exchange believes that the proposed rule change will protect investors and the public interest by helping to assure that retail customers continue to receive the appropriate marketplace advantages on the Exchange and in the marketplace as intended, while furthering competition among marketplace professionals by treating them in the same manner as other similarly situated market participants. The Exchange believes that it is consistent with Section 6(b)(5)<sup>23</sup> of the Act not to afford market participants with similar access to information and technology as that of brokers and dealers of securities with marketplace advantages over such marketplace competitors. The Exchange also believes that the proposed rule change would help to remove burdens on competition and promote a more competitive marketplace by affording certain marketplace advantages only to those for whom they are intended. Finally, the Exchange believes that the proposed rule change sets forth a more detailed and clear regulatory regime with respect to calculating average daily order entry for Professional order counting purposes. The Exchange believes that this additional clarity and detail will eliminate confusion among market participants, which is in the interests of all investors and the general public.

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<sup>22</sup> 15 U.S.C. 78f(b)(8).

<sup>23</sup> 15 U.S.C. 78f(b)(5).

Based on the foregoing, the Exchange believes the proposal, which establishes an objective methodology for counting average daily order submissions for Professional order counting purposes, is consistent with the Act.

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

The Exchange does not believe that its proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange believes that the proposed rule change will help ensure fairness in the marketplace and promote competition among all market participants. The Exchange believes that this proposal would help establish more competition among market participants and promote the purposes for which the Exchange's Professional rule was originally adopted. Moreover, the proposal would ensure consistency and help to eliminate confusion as to the manner in which options exchanges compute the Professional order volume.

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

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from Members or other interested parties.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (A) significantly affect the protection of investors or the public interest; (B) impose any significant burden on competition; and (C) by its terms, become operative for 30 days from the date on which it

was filed or such shorter time as the Commission may designate it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>24</sup> and paragraph (f)(6) of Rule 19b-4 thereunder,<sup>25</sup> the Exchange has designated this rule filing as non-controversial. The Exchange has given the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (1) necessary or appropriate in the public interest; (2) for the protection of investors; or (3) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal is consistent with the Act.

Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-BatsEDGX-2016-28 on the subject line.

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<sup>24</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>25</sup> 17 CFR 240.19b-4.

Paper Comments:

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

All submissions should refer to File No. SR-BatsEDGX-2016-28. 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 am and 3:00 pm. Copies of such filing will also 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 No. SR-BatsEDGX-2016-28 and should be submitted on or before [\_\_\_\_\_21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to

delegated authority.<sup>26</sup>

Robert W. Errett  
Deputy Secretary

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<sup>26</sup> 17 CFR 200.30-3(a)(12).

## EXHIBIT 5

Note: Proposed new language is underlined. Proposed deletions are enclosed in [brackets].

**Rules of Bats EDGX Exchange, Inc.**

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**CHAPTER XVI. GENERAL PROVISIONS – EDGX OPTIONS**

## Rule 16.1. Definitions

(a) (No change.)

(1)-(45) (No change.)

(46) The term “Professional” means any person or entity that: (A) is not a broker or dealer in securities; and (B) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). All Professional orders shall be appropriately marked by Options Members.

(47)-(63) (No change.)

*Interpretations and Policies*

.01 Calculation of Professional Orders. Except as noted below, each order of any order type counts as one order for Professional order counting purposes.

(a) Complex Orders:

(1) A complex order comprised of eight (8) option legs or fewer counts as a single order;

(2) A complex order comprised of nine (9) option legs or more counts as multiple orders with each option leg counting as its own separate order;

(b) “Parent”/“Child” Orders:

(1) Same Side and Same Series: A “parent” order that is placed for the beneficial account(s) of a person or entity that is not a broker or dealer in securities that is broken into multiple “child” orders on the same side (buy/sell) and series as the “parent” order by a broker or dealer, or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer, but which is housed with the customer, counts as one order even if the “child” orders are routed across multiple exchanges.

(2) Both Sides and/or Multiple Series: A “parent” order (including a strategy order) that is broken into multiple “child” orders on both sides (buy/sell) of a series

and/or multiple series counts as multiple orders, with each “child” order counting as a new and separate order.

(c) Cancel/Replace:

(1) Except as provided in paragraph (c)(2) below, any order that cancels and replaces an existing order counts as a separate order (or multiple new orders in the case of a complex order comprised of nine (9) option legs or more).

(2) Same Side and Same Series: An order that cancels and replaces any “child” order resulting from a “parent” order that is placed for the beneficial account(s) of a person or entity that is not a broker, or dealer in securities that is broken into multiple “child” orders on the same side (buy/sell) and series as the “parent” order by a broker or dealer, by an algorithm housed at a broker or dealer, or by an algorithm licensed from a broker or dealer, but which is housed with the customer, does not count as a new order.

(3) Both Sides and/or Multiple Series: An order that cancels and replaces any “child” order resulting from a “parent” order (including a strategy order) that generates “child” orders on both sides (buy/sell) of a series and/or in multiple series counts as a new order.

(4) Pegged Orders: Notwithstanding the provisions of paragraph (c)(2) above, an order that cancels and replaces any “child” order resulting from a “parent” order being “pegged” to the BBO or NBBO or that cancels and replaces any “child” order pursuant to an algorithm that uses BBO or NBBO in the calculation of “child” orders and attempts to move with or follow the BBO or NBBO of a series counts as a new order each time the order cancels and replaces in order to attempt to move with or follow the BBO or NBBO.

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