SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–77171; File No. SR–BATS–2015–101]

Self-Regulatory Organizations; BATS Exchange, Inc.; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, To Adopt Rule 8.17 To Provide a Process for an Expedited Suspension Proceeding and Rule 12.15 To Prohibit Disruptive Quoting and Trading Activity

February 18, 2016.

I. Introduction

On November 6, 2015, BATS Exchange, Inc. (''BATS'' or the ''Exchange'') filed with the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] a proposed rule change to adopt new BATS Rule (''Rule'') 12.15, which would prohibit certain disruptive quoting and trading activities on the Exchange, and new Rule 8.17, which would permit BATS to conduct a new Expedited Client Suspension Proceeding when it believes proposed Rule 12.15 has been violated.[3] On November 17, 2015, the Exchange filed Amendment No. 1 to the proposal.[4] The proposed rule change, as modified by Amendment No. 1, was published for comment in the **Federal Register** on November 24, 2015.[5] On January 6, 2016, pursuant to Section 19(b)(2) of the Act,[6] the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.[7] The Commission received four comment letters on the proposal and a response to the comments from the Exchange.[8] The Commission also received a recommendation regarding the proposed rule change from the Office of the Investor Advocate (''OIAD'').[9] This order approves the proposed rule change, as modified by Amendment No. 1.

II. Description of the Proposed Rule Change

The Exchange states that, in order to fulfill certain of its responsibilities as a registered national securities exchange and self-regulatory organization, it has developed a comprehensive regulatory program that includes automated surveillance of trading activity that is operated directly by Exchange staff and by staff of the Financial Industry Regulatory Authority (''FINRA'') pursuant to a Regulatory Services Agreement.[10] According to the Exchange, under this regulatory program, it can often take several years to resolve cases involving disruptive and potentially manipulative or improper quoting and trading activity even though, in some cases, the improper activity is able to be identified in real-time or near real-time.[11] As a result, the Exchange states that Exchange members (''Members'') responsible for such conduct, or responsible for their customers' conduct, are allowed to continue the disruptive quoting and trading activity on the Exchange and other exchanges during the entirety of such lengthy investigations and enforcement processes.[12] In the Notice, the Exchange provides examples of recent cases in which this has occurred.[13]

The Exchange believes that a lengthy investigation and enforcement process is generally necessary and appropriate to afford the subject Member adequate due process.[14] However, it also believes ''that there are certain obvious and uncomplicated cases of disruptive and manipulative behavior or cases where the potential harm to investors is so large that the Exchange should have the authority to initiate an expedited suspension proceeding in order to stop the behavior from continuing on the Exchange.'' [15] The Exchange further states that it should have such authority if a Member is engaging in or facilitating disrupting quoting and trading activity, and the Member has received sufficient notice with an opportunity to respond, but such activity has not ceased.[16]

The Exchange therefore has proposed to adopt new Rule 12.15, which would expressly prohibit two specific types of disruptive quoting and trading activities, and new Rule 8.17, which would permit the Exchange to conduct an Expedited Client Suspension Proceeding when it believes new Rule 12.15 has been violated.[17]

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] As discussed in Section II, this proposed rule change is a revised version of a prior filing, BATS–2015–57, which the Exchange withdrew on November 6, 2015. *See* Securities Exchange Act Release No. 76393 (November 9, 2015), 80 FR 70851 (November 16, 2015) (BATS–2015–57) (notice of withdrawal of BATS–2015–57). BATS filed BATS–2015–101 in order to address certain issues raised by comments submitted with respect to BATS–2015–57.

[4] Amendment No. 1 amended and replaced the original proposal in its entirety.

[5] *See* Securities Exchange Act Release No. 76470 (November 18, 2015), 80 FR 73247 (''Notice'').

[6] 15 U.S.C. 78s(b)(2).

[7] *See* Securities Exchange Act Release No. 76841, 81 FR 1457 (January 12, 2016). The Commission designated February 22, 2016 as the date by which it should approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change.

[8] *See* letters from: R.T. Leuchtkafer to Brent J. Fields, Secretary, Commission, dated December, 14, 2015 (''Leuchtkafer Letter II''); Samuel F. Lek, Chief Executive Officer, Lek Securities Corporation, dated December 28, 2015 (''Lek Letter III''); G.T. Spaulding to Brent J. Fields, Secretary, Commission, dated December, 28, 2015 (''Spaulding Letter''); R.T. Leuchtkafer to Brent J. Fields, Secretary, Commission, dated February 2, 2016 (''Leuchtkafer Letter III''); and response letter regarding SR–BATS–2015–101 from Anders Franzon, SVP Associate General Counsel, BATS, to Brent J. Fields, Secretary, Commission, dated January 21, 2016 (''BATS Response Letter II''). In addition, the Commission received comments regarding the prior filing, SR–BATS–2015–57, which this proposal revises and replaces. *See* comment letters regarding SR–BATS–2015–57 from: Teresa Machado B., dated August 19, 2015 (''Machado Letter''); Samuel F. Lek, Chief Executive Officer, Lek Securities Corporation, dated September 3, 2015 (''Lek Letter I''); R.T. Leuchtkafer to Brent J. Fields, Secretary, Commission, dated September, 4, 2015 (''Leuchtkafer Letter I''); Mary Ann Burns, Chief Operating Officer, FIA Principal Traders Group, to Brent J. Fields, Secretary, Commission, dated September, 9, 2015 (''FIA Letter''); and Samuel F. Lek, Chief Executive Officer, Lek Securities Corporation, dated September 18, 2015 (''Lek Letter II''). The Exchange submitted a response to these comments in conjunction with its withdrawal of SR–BATS–2015–57 and filing of this proposal. *See* response letter regarding SR–BATS–2015–57 from Anders Franzon, VP and Associate General Counsel, BATS, to Brent J. Fields, Secretary, Commission, dated November 6, 2015 (''BATS Response Letter I''). The comments pertaining to the current proposal, the comments pertaining to SR–BATS–2015–57, and the Exchange's responses to the comments are all summarized below.

[9] *See* Memorandum to the Commission from Rick A. Fleming, Office of the Investor Advocate, Commission, dated December 15, 2015 (''OIAD Recommendation''). As discussed in more detail below, the Commission has carefully considered the OIAD Recommendation. The OIAD was established pursuant to Section 915 of the Dodd Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, sec. 911, 124 Stat. 1376, 1822 (July 21, 2010) (the ''Dodd-Frank Act''). The Dodd-Frank Act authorizes the Investor Advocate, among other things, to identify areas in which investors would benefit from changes in the regulations of the Commission or the rules of self-regulatory organizations and to propose to the Commission changes in the regulations or orders of the Commission that may be appropriate to promote the interests of investors.

[10] *See* Notice, *supra* note 5, at 73247–48.

[11] *Id.* at 73248.

[12] *Id.*

[13] *Id.* The Exchange notes that these cases involved allegations of wide-spread market manipulation, and in each case, the conduct involved a pattern of disruptive quoting and trading activity indicative of manipulative layering or spoofing. *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] The Exchange notes that it currently has authority to prohibit and take action against manipulative trading activity, including disruptive quoting and trading activity, pursuant to its general market manipulation rules, including Rule 3.1. *Id.* at 73250.

Proposed Rule 12.15

Proposed Rule 12.15 would state that no Member shall engage in or facilitate disruptive quoting and trading activity—as described in Interpretations and Policies .01 and .02 of proposed Rule 12.15—on the Exchange, including acting in concert with other persons to affect such activity.[18]

Proposed Interpretation and Policy .01 would describe the quoting and trading activities prohibited by proposed Rule 12.15 and state that, for purposes of proposed Rule 12.15, disruptive quoting and trading activity shall include a frequent pattern of two fact scenarios, defined as ''Disruptive Quoting and Trading Activity Type 1'' and ''Disruptive Quoting and Trading Activity Type 2,'' respectively. Disruptive Quoting and Trading Activity Type 1 would entail a frequent pattern in which the following facts are present: (1) A party enters multiple limit orders on one side of the market at various price levels (the ''Displayed Orders''); (2) following the entry of the Displayed Orders, the level of supply and demand for the security changes; (3) the party enters one or more orders on the opposite side of the market of the Displayed Orders (the ''Contra-Side Orders'') that are subsequently executed; and (4) following the execution of the Contra-Side Orders, the party cancels the Displayed Orders. Disruptive Quoting and Trading Activity Type 2 would entail a frequent pattern in which the following facts are present: (1) A party narrows the spread for a security by placing an order inside the national best bid and offer (''NBBO''); and (2) the party then submits an order on the opposite side of the market that executes against another market participant that joined the new inside market established by the party.

Proposed Interpretation and Policy .02 would state that, for purposes of proposed Rule 12.15, disruptive quoting and trading activity shall include a frequent pattern in which the facts listed in Interpretation and Policy .01 are present. Proposed Interpretation and Policy .02 would also state that, unless otherwise indicated, the order of the events indicating the pattern does not modify the applicability of proposed Rule 12.15. Further, proposed Interpretation and Policy .02 would state that disruptive quoting and trading activity includes a pattern or practice in which all of the quoting and trading activity is conducted on the Exchange as well as a pattern or practice in which some portion of the quoting or trading activity is conducted on the Exchange and the other portions of the quoting or trading activity are conducted on one or more other exchanges.

Proposed Rule 8.17

Under proposed Rule 8.17, the Exchange could initiate an Expedited Client Suspension Proceeding when it believes that proposed Rule 12.15 has been violated. An Expedited Client Suspension Proceeding could result in the Exchange issuing a ''suspension order,'' under which a Respondent to the proceeding that was provided with advanced notice could be (1) ordered to cease and desist from the violative trading activity under proposed Rule 12.15 and/or ordered to cease and desist from providing access to the Exchange to a client engaging in the violative trading activity under proposed Rule 12.15, and (2) suspended from the Exchange unless and until it takes or refrains from taking the act or acts described in the suspension order.[19]

Paragraph (a) of proposed Rule 8.17 would govern the initiation of an Expedited Client Suspension Proceeding. With the prior written authorization of the Exchange's Chief Regulatory Officer (''CRO'') or such other senior officers as the CRO may designate, the Office of General Counsel or Regulatory Department of the Exchange may initiate an Expedited Client Suspension Proceeding. The Exchange would initiate an Expedited Client Suspension Proceeding by serving a notice on a Member or associated person of a Member (''Respondent''), and the notice would be effective upon service.[20] The notice would state whether the Exchange is requesting the Respondent to be required to take action or to refrain from taking action, and would be accompanied by the following: (1) A declaration of facts, signed by a person with knowledge of the facts contained therein, that specifies the acts that constitute the alleged violation; and (2) a proposed order that contains the required elements of a suspension order (except the date and hour of the order's issuance).[21]

Paragraph (b) of proposed Rule 8.17 would govern the appointment of a Hearing Panel to preside over an Expedited Client Suspension Proceeding and the recusal or disqualification of a Hearing Officer from the Hearing Panel under certain circumstances. Proposed Rule 8.17(b)(1) would require the assignment of a Hearing Panel as soon as practicable after the Exchange initiates an Expedited Client Suspension Proceeding.[22] Proposed Rule 8.17(b)(2) would provide for the recusal or disqualification of a Hearing Officer in the event he or she has a conflict of interest or bias or other circumstances exist where his or her fairness might reasonably be questioned. The proposed rule would permit a Hearing Officer to recuse himself or herself and also permit a party to the proceeding to file a motion to disqualify a Hearing Officer. Proposed Rule 8.17(b) would require a recusal and disqualification proceeding to be held under such circumstances, which would be conducted in accordance with current Rule 8.6(b).[23] However, proposed Rule 8.17(b) would provide for shorter timeframes within which a motion to disqualify a Hearing Officer must be filed and within which the Exchange may respond to that motion than those set forth in Rule 8.6(b).[24] The Exchange states that proposed Rule 8.17(b) provides for these shorter time periods due to the compressed schedule pursuant to which an Expedited Client Suspension Proceeding would operate.[25]

Under paragraph (c) of proposed Rule 8.17, a hearing would be held no later than 15 days after service of the notice initiating the Expedited Client Suspension Proceeding, unless

[18] The Exchange believes that it is necessary to extend the prohibition of proposed Rule 12.15 to situations when persons are acting in concert to avoid a potential loophole where disruptive quoting and trading activity is simply split between several brokers or customers. *See* Notice, *supra* note 5, at 73250.

[19] *See* proposed Rule 8.17(d)(2).

[20] Under proposed Rule 8.17, relevant documents (*e.g.,* notice, the suspension order) may be served via personal service or overnight commercial carrier. *See* proposed Rules 8.17(a)(2), 8.17(c)(2), 8.17(d)(4), and 8.17(e).

[21] *See* proposed Rule 8.17(a)(3).

[22] The Hearing Panel would be appointed in accordance with current Rule 8.6(a), which states, among other things, that a Hearing Panel for general disciplinary proceedings shall be comprised of three hearing officers appointed by the Chief Executive Officer of the Exchange. *See* Rule 8.6(a). Rule 8.6(a) further states that each Hearing Panel shall be comprised of: (1) A professional hearing officer, who shall serve as Chairman of the Hearing Panel, (2) a hearing officer who is an Industry member, as such term is defined in the Exchange's By-Laws, and (3) a hearing officer who is a Member Representative member, as such term is defined in the Exchange's By-Laws. *Id.*

[23] *See* Rule 8.6(b). Rule 8.6(b) sets forth the Exchange's standard for the impartiality of Hearing Officers for general disciplinary proceedings and the process for removing a Hearing Officer due to bias or conflict of interest. *Id.*

[24] Under proposed Rule 8.17(b)(2), a motion seeking disqualification of a Hearing Officer would be required to be filed no later than five days after the announcement of the Hearing Panel, and the Exchange would be permitted to file a brief in opposition to that motion no later than five days after service thereof. Rule 8.6(b) provides for a 15-day period to file a motion to disqualify a Hearing Officer and a 15-day period for the Exchange to respond.

[25] *See* Notice, *supra* note 5, at 73249.

otherwise extended by the Chairman of the Hearing Panel with the consent of the parties to the proceeding for good cause shown. In the event of a recusal or disqualification of a Hearing Officer, the hearing would be held no later than five days after a replacement Hearing Officer is appointed. A notice of the date, time, and place of the hearing would be required to be served on the parties to the proceeding no later than seven days before the hearing, unless otherwise ordered by the Chairman of the Hearing Panel. Proposed Rule 8.17(c) would also govern the conduct of the hearing by including provisions addressing the authority of the Hearing Officers, the testimony of witnesses, the submission of additional information to the Hearing Panel, the requirement that a transcript of the proceeding be created (and the details related to availability of and corrections to such transcript), and the creation and maintenance of the record of the proceeding. Proposed Rule 8.17(c) would also provide that the Hearing Panel may issue a suspension order without further proceedings if the Respondent fails to appear at the hearing, and that the Hearing Panel may dismiss the Expedited Client Suspension Proceeding if the Exchange fails to appear at the hearing.

Under paragraph (d) of proposed Rule 8.17, the Hearing Panel would be required to issue a written decision stating whether a suspension order would be imposed. The Hearing Panel would be required to issue the decision no later than ten days after receipt of the hearing transcript, unless otherwise extended by the Chairman of the Hearing Panel with the consent of the parties to the proceeding for good cause shown. Pursuant to proposed Rule 8.17(d)(1), a suspension order would be imposed if the Hearing Panel finds: (1) by a preponderance of the evidence that the alleged violation specified in the notice has occurred and (2) that the violative conduct or continuation thereof is likely to result in significant market disruption or other significant harm to investors.

Proposed Rule 8.17(d)(2) would set forth the content, scope, and form of a suspension order. Specifically, the suspension order would be limited to: (1) ordering a Respondent to cease and desist from violating proposed Rule 12.15; and/or (2) ordering a Respondent to cease and desist from providing access to the Exchange to a client of Respondent that is causing violations of proposed Rule 12.15.[26] The suspension order would be required to set forth the alleged violation and the significant market disruption or other significant harm to investors that is likely to result without the issuance of an order, to describe, in reasonable detail, the act or acts the Respondent is to take or refrain from taking, and to suspend the Respondent unless and until such action is taken or refrained from.[27] Under proposed Rules 8.17(d)(3) and 8.17(d)(4), a suspension order would be effective upon service and remain effective and enforceable unless modified, set aside, limited, or revoked pursuant to proposed Rule 8.17(e).[28]

Paragraph (e) of proposed Rule 8.17 would provide that, at any time after the Respondent is served with a suspension order, a party to the Expedited Client Suspension Proceeding may apply to the Hearing Panel to have the order modified, set aside, limited, or revoked. Further, under proposed Rule 8.17(e), the Hearing Panel would be required to respond to any such request in writing within ten days after receipt of the request, unless otherwise extended by the Chairman of the Hearing Panel with the consent of the parties to the proceeding for good cause shown. In addition, proposed Rule 8.17(e) would state that an application to modify, set aside, limit or revoke a suspension order would not stay the effectiveness of the suspension order. In the Notice, the Exchange explains that if any part of a suspension order is modified, set aside, limited, or revoked, proposed Rule 8.17(e) would grant the Hearing Panel discretion to leave the cease and desist part of the order in place while, for example, removing the suspension component.[29]

Finally, paragraph (f) of proposed Rule 8.17 would state that sanctions issued under proposed Rule 8.17 would constitute final and immediately effective disciplinary sanctions imposed by the Exchange, that the right to have any action under proposed Rule 8.17 reviewed by the Commission would be governed by Section 19 of the Act,[30] and that the filing of an application for review would not stay the effectiveness of a suspension order unless the Commission otherwise orders.

In the Notice, the Exchange notes that the issuance of a suspension order would not alter the Exchange's ability to further investigate the matter and/or later sanction the Member pursuant to the Exchange's standard disciplinary process for supervisory violations or other violations of Exchange rules or the Act.[31] In addition, in the Notice, the Exchange acknowledges that its proposed authority to issue a suspension order is a powerful measure that should be used very cautiously.[32] Consequently, according to the Exchange, the proposed rules have been designed to ensure that the Expedited Client Suspension Proceedings are used to address only the most clear and serious types of disruptive quoting and trading activity and that the interests of Respondents are protected.[33] In addition, the Exchange believes that it would use this authority in limited circumstances, when necessary to protect investors, other Members, and the Exchange.[34]

Summary of Differences Between BATS–2015–57 and the Current Proposal

As noted above, this proposal revises and replaces a prior proposal, BATS–2015–57, which the Exchange withdrew in order to address certain comments.[35] In conjunction with that withdrawal and replacement, the Exchange submitted a comment response letter that, among other things, explained the main differences between the prior proposal and the current proposal (the letter also addressed certain comments on BATS–2015–57, as described below).[36] As set forth in that letter, the current proposal replaces the terms ''Layering'' and ''Spoofing'' originally used in proposed Rule 12.15 of BATS–2015–57 with the terms ''Disruptive Quoting and Trading Activity Type 1'' and ''Disruptive Quoting and Trading Activity Type 2,'' respectively, and conforms related terminology in proposed Rules 8.17 and 12.15.[37] Because the Exchange also believes that a suspension order issued under proposed Rule 8.17 is enforceable against the subject Member and no additional process is required to discipline the violation of such an order, the current proposal omits subparagraph (f) of proposed Rule 8.17 of BATS–2015–57, which had provided a process for sanctioning violations of a

[26] *See supra* note 18 and accompanying text.

[27] The suspension order would also include the date and hour of its issuance. *See* proposed Rule 8.17(d)(2)(D).

[28] *See infra.*

[29] *See* Notice, *supra* note 5, at 73249. In addition, the Exchange also explains that, with its broad modification powers under the proposed rule, the Hearing Panel would maintain the discretion to impose conditions upon the removal of a suspension. *Id.*

[30] 15 U.S.C. 78s.

[31] *See* Notice, *supra* note 5, at 73251.

[32] *Id.*

[33] *Id.*

[34] *Id.*

[35] *See supra* note 3.

[36] *See* BATS Response Letter I, *supra* note 8.

[37] *Id.* at 5; *also compare* BATS–2015–57 *with* BATS–2015–101.

suspension order,[38] and also make a conforming change to what is now Rule 8.17(f) of BATS–2015–101. In addition, the current proposal modifies subparagraph (d)(2)(C) of proposed Rule 8.17 to clarify that a suspension order would suspend the Respondent from access to the Exchange unless and until there is compliance with the cease and desist provisions of the order.[39]

III. Summary of Comments

The Commission received four comments from three different commenters on this proposal and a comment response letter from the Exchange.[40] The Commission also received five comment letters from four different commenters on BATS–2015–57,[41] as well as a comment response letter from the Exchange.[42] One of the commenters on this proposal, who also commented twice on BATS–2015–57,[43] opposes the proposal.[44] Another commenter on this proposal, who also commented on BATS–2015–57,[45] is critical of the scope of the defined trading activities prohibited under proposed Rule 12.15.[46] Two commenters on BATS–2015–57 (who did not also comment on this proposal) supported the prior proposal overall,[47] but one of them suggested a clarifying amendment.[48] Additionally, the OIAD submitted to the public comment file its recommendation that the Commission approve this proposal.[49] The comment letters received with respect to BATS–2015–57 and this proposal, as well as the Exchange's responses, are summarized below, followed by a summary of the OIAD Recommendation.

Proposed Definitions of ''Spoofing'' and ''Layering'' in BATS–2015–57 and ''Disruptive Quoting and Trading Activity'' in the Current Proposal

Most of the critical commentary on BATS–2015–57 centered on proposed Rule 12.15's description of the ''layering'' and ''spoofing'' activity that would be prohibited.[50] One commenter who supported BATS–2015–57 expressed broad agreement with the proposed descriptions of such activity, but believed that the descriptions should be amended to require a manipulative intent element.[51] This commenter noted prior definitions of ''spoofing'' put forth by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (''Dodd-Frank Act'') and in Commodity Futures Trading Commission guidance, which definitions include an intent element.[52] According to this commenter, the omission of such an intent element raised a concern because it ''is the cornerstone of existing disruptive trading rules'' and ''has historically been an important factor in sanctioning market participants for fraudulent and manipulative trading practices as it prevents legitimate, good faith actions from being wrongly penalized.'' [53] This commenter stated that, without the intent requirement, proposed Rule 12.15, and its description of prohibited layering activity in particular, could be construed to prohibit a broad range of legitimate conduct such as market making activity.[54]

Another commenter who was opposed to BATS–2015–57 stated that the proposed descriptions of the prohibited ''layering'' and ''spoofing'' activity in BATS–2015–57 were overbroad and would encompass legitimate trading activity in which trading algorithms regularly engage, and that narrows spreads, adds depth and liquidity to the market, provides price improvement, and reduces costs for investors.[55] The commenter stated that prohibiting such trading activity would be anti-competitive and would serve to eliminate risk to market participants engaged in front-running strategies because they would be provided with a free stop-loss on their trades.[56] This commenter addressed each element of the proposed ''layering'' and ''spoofing'' descriptions in BATS–2015–57 and offered its view as to why each individual element encompassed legitimate trading activity or was otherwise problematic.[57] The commenter further asserted that courts have held that an alleged manipulator must inject false information into the market with scienter, and that orders do not become manipulative merely because another trader speculates about them incorrectly.[58] The commenter also argued that the proposed descriptions of ''layering'' and ''spoofing'' were unacceptably vague.[59] According to the commenter, by using the words ''include,'' ''frequent,'' ''pattern,'' and ''multiple,'' the proposed descriptions in BATS–2015–57 left open-ended exactly what conduct would be prohibited.[60]

Another commenter also criticized the proposed descriptions of the prohibited ''layering'' and ''spoofing'' activity under that proposal, but instead expressed concern that the proposed descriptions were too narrow and would have given ''spoofers and layerers a roadmap around exchange surveillance, and a near-perfect defense if they're somehow roped into an enforcement action.'' [61] This commenter noted that other definitions of layering and spoofing, such as that put forth by the Dodd-Frank Act, ''define spoofing or layering (collectively, 'spoofing') as a matter of the spoofer's intent without detailing exactly where and how orders are placed or at what prices.'' [62] According to this commenter, by being specific in proposed Rule 12.15, the proposed descriptions of the prohibited ''layering'' and ''spoofing'' activity would have excluded certain kinds of improper trading activity.[63] The commenter asserted that BATS should instead adopt principles-based language against spoofing.[64] The commenter also

[38] *See* BATS Response Letter I, *supra* note 8, at 5.

[39] *Id.* In Amendment No. 1, the Exchange relocated this provision addressing suspension from the Exchange from subparagraph (d)(2)(A) of proposed Rule 8.17 to subparagraph (d)(2)(C) of proposed Rule 8.17.

[40] *See supra* note 8.

[41] *Id.*

[42] *Id.* As noted above, the Exchange submitted its response letter in conjunction with its withdrawal of BATS–2015–57 and filing of BATS–2015–101. *Id.*

[43] *See* Lek Letters I and II, *supra* note 8.

[44] *See* Lek Letter III, *supra* note 8.

[45] *See* Leuchtkafer Letter I, *supra* note 8.

[46] *See* Leuchtkafer Letters II and III, *supra* note 8. *See also* Spaulding Letter, *supra* note 8 (appearing to be critical of the proposal).

[47] *See* FIA Letter, *supra* note 8; Machado Letter, *supra* note 8.

[48] *See* FIA Letter, *supra* note 8.

[49] *See* OIAD Recommendation, *supra* note 9.

[50] *See* FIA Letter, *supra* note 8, at 3–4; Leuchtkafer Letter I, *supra* note 8; Lek Letter I, *supra* note 8, at 1–6, Lek Letter II, *supra* note 8. As noted above, in the current proposal, the Exchange changed the labels of the activities prohibited under proposed Rule 12.15 from ''Layering'' and ''Spoofing'' to ''Disruptive Quoting and Trading Activity Type 1'' and ''Disruptive Quoting and Trading Activity Type 2,'' respectively. The Exchange did not make any other substantive changes to the definitions or descriptions of the activities prohibited under proposed Rule 12.15, and accordingly, the Commission believes that the comments received regarding proposed Rule 12.15 under BATS–2015–57 are appropriate to consider with respect to the current proposal.

[51] *See* FIA Letter, *supra* note 8, at 1, 4. The other supportive commenter stated that a biotech company in which the commenter is an investor has been subject to spoofing and layering, as well as naked short attacks, which is severely harming *bona fide* investors. *See* Machado Letter, *supra* note 8.

[52] *See* FIA Letter, *supra* note 8, at 2–3.

[53] *Id.* at 3–4.

[54] *Id.* at 4 n.13.

[55] *See* Lek Letter I, *supra* note 8, at 1, 7.

[56] *See* Lek Letter I, *supra* note 8, at 1, 6; Lek Letter II, *supra* note 8.

[57] *See* Lek Letter I, *supra* note 8, at 2–6.

[58] *See* Lek Letter I, *supra* note 8, at 2; Lek Letter II, *supra* note 8.

[59] *See* Lek Letter I, *supra* note 8, at 2–4.

[60] *Id.*

[61] *See* Leuchtkafer Letter I, *supra* note 8, at 1. *See also* Leuchtkafer Letter III, *supra* note 8, at 2–3.

[62] *See* Leuchtkafer Letter I, *supra* note 8, at 2.

[63] *Id.* at 3, 6.

[64] *Id.* at 6. In addition, the commenter criticized certain market making practices that the commenter attributed to high-frequency traders, and suggested that these practices are anti-competitive and

expressed concern that other exchanges might copy BATS's definitions of spoofing and layering.[65]

In response to the above critiques of the proposed definitions of ''spoofing'' and ''layering'' in BATS–2015–57, the Exchange stated in its response letter for BATS–2015–57 that it agrees that the harmful practices of spoofing and layering are defined by an intent element.[66] According to the Exchange, the prior proposal's definitions of the prohibited ''layering'' and ''spoofing'' activity under proposed Rule 12.15 were intended to include an intent element by requiring a ''frequent pattern'' of such activity.[67] The Exchange stated that a ''frequent pattern'' of such activity evidences manipulative intent,[68] and offered the observation that such a ''frequent pattern'' is typically the key factor indicating intent in spoofing and layering cases.[69] The Exchange also acknowledged the concern that the proposed ''layering'' and ''spoofing'' definitions in the prior proposal could be read to exclude other spoofing and layering practices.[70] The Exchange stated that it did not intend to provide universal definitions of layering and spoofing activity, but rather to identify and prohibit ''certain patterns and practices that are hallmarks of the most egregious spoofing and/or layering conduct.'' [71]

Nevertheless, the Exchange recognized commenters' concerns that certain non-spoofing or non-layering trading activity could fall within the previously proposed definitions of ''layering'' and ''spoofing'' while, at the same time, certain manipulative layering or spoofing activity could fall outside those proposed definitions.[72] The Exchange stated that, because the purpose of BATS–2015–57 was ''not to provide a precise definition of layering and spoofing, but to protect market participants from the harm caused by a [Member's] refusal to cease obvious disruptive market practices,'' the Exchange modified the defined terms in proposed Rule 12.15 under the current proposal to replace the defined terms ''layering'' and ''spoofing'' with the terms ''Disruptive Quoting and Trading Activity Type 1'' and ''Disruptive Quoting and Trading Activity Type 2,'' respectively.[73] The Exchange stated its belief that this terminology change advances its objective of protecting market participants from harmful and manipulative trading behavior, and also alleviates commenters' concerns regarding the prior definitions of ''layering'' and ''spoofing'' [74] According to the Exchange, the terminology change also highlights that proposed Rule 8.17 is ''designed to halt a very specific, readily identifiable type of illegal trading activity rather than an attempt to define and punish layering and spoofing in every conceivable context.'' [75]

The commenter who opposed the prior proposed rule change in BATS–2015–57 submitted a comment letter on the current proposal, again in opposition.[76] In this comment letter, the commenter repeats many of the same criticisms set forth in the commenter's first letter submitted in opposition to BATS–2015–57,[77] asserting that ''the currently proposed rule has all the flaws of the original proposal.'' [78] The commenter also repeats its criticism from its second comment letter to BATS–2015–57 that the proposed rule change is intended to eliminate competition for high-frequency traders (''HFTs'')—whom the commenter claims ''control'' the Exchange—at the expense of institutional investors by eliminating trading strategies that add risk to front-running strategies of HFTs.[79] The commenter claims that the Exchange is advocating ''the ability for HFTs to detect institutional buying interest and to be able to front-run institutional orders risk free.'' [80] In its comment response letter for the current proposal, the Exchange incorporates, by reference, the statements in its comment response letter for BATS–2015–57 addressing the commenter's criticisms of BATS–2015–57 that are duplicative of the commenter's criticism of the current proposal.[81] The Exchange also states that the trading activity it seeks to curtail under the proposal is ''not acceptable 'competitive' conduct'' and that there is no risk that the proposed Expedited Client Suspension Proceeding ''could be used to prohibit an isolated series of coincidental transactions,'' as asserted by the commenter.[82]

Additionally, one of the commenters critical of the proposed definitions of ''layering'' and ''spoofing'' under BATS–2015–57 submitted a comment letter to BATS–2015–101 that reprises much of the same criticism set forth in the commenter's letter in opposition to BATS–2015–57 and again centers on the Exchange's descriptions and definitions of the prohibited trading activities in proposed Rule 12.15.[83] The commenter argues that the Exchange should not define the prohibited activity in ''narrow, prescriptive terms'' and that the proposed definitions of the violative activity are inconsistent with the ''principles-based'' definitions of what the commenter characterizes as ''[a]ll other definitions of spoofing that [the commenter] could find that regulators (including BATS) have set down over the years.'' [84] The commenter reiterates its view that the Exchange should include principle-based language in its proposed rule and suggests specific rule language in this regard, which includes an intent element,[85] and expresses renewed concern that BATS's ''deeply flawed and superficial proposal could quickly become the surveillance and enforcement spoofing standard for the equity markets.'' [86]

In response to this comment letter, the Exchange explains that ''[d]efining layering and spoofing in all of its possible permutations is not the

contribute to market complexity. *Id.* at 3–5. The commenter also questioned how such market making activity can be distinguished from spoofing in certain contexts. *Id.* at 4–6. The commenter further questioned why BATS has proposed to expedite action in cases of spoofing or layering but not in cases of other types of manipulative trading, like marking the close or wash trading. *Id.* at 1.

[65] *Id.* at 1; *see also id.* at 6.

[66] *See* BATS Response Letter I, *supra* note 8, at 6.

[67] *Id.*

[68] *Id.*

[69] *Id.* at 6 n.12.

[70] *Id.* at 7.

[71] *Id.* The Exchange also argued, in response to one commenter's assertions that elements of the proposed definitions violated the Act, that since spoofing and layering are fraudulent and manipulative practices prohibited by the Act, the previously proposed rules prohibiting those practices comport with Section 6(b)(5) of the Act and advance the Act's purposes. *Id.* at 11.

[72] *Id.* at 7.

[73] *Id.*

[74] *Id.*

[75] *Id.* at 7–8.

[76] *See* Lek Letter III, *supra* note 8.

[77] *Compare* Lek Letter I, *supra* note 8, *with* Lek Letter III, *supra* note 8.

[78] *See* Lek Letter III, *supra* note 8, at 1.

[79] *Id.* at 1–2. *Compare* Lek Letter II *supra* note 8, *with* Lek Letter III, *supra* note 8.

[80] *See* Lek Letter III, *supra* note 8, at 2. The commenter states that HFTs ''seek to buy stock ahead of the institution, bid up the price, and re-sell the stock back to the institution at a higher level'' and argues that HFTs ''therefore seek regulatory protections and advocate rules that would eliminate trading strategies that add such risk to their front running strategies.'' *Id.*

[81] *See* BATS Response Letter II, *supra* note 8, at 10.

[82] *Id.* (responding to Lek Letter III).

[83] *Compare* Leuchtkafer Letter II, *supra* note 8, *with* Leuchtkafer Letter I, *supra* note 8.

[84] *See* Leuchtkafer Letter II, *supra* note 8, at 1–2.

[85] *Id.* at 8.

[86] *Id.* at 3. The commenter also renews its critique of certain market making practices that the commenter attributes to HFTs, and again suggests that these practices are anti-competitive and contribute to market complexity, and questions how such market making activity can be distinguished from spoofing in certain contexts. *Id.* at 3–8. In addition, the commenter asserts that it is unaware of any spoofing or layering case in which the Exchange independently discovered the violative conduct at issue. *Id.* at 1–2.

purpose of this filing.'' [87] Rather, the Exchange states that the filing is meant to ''supplement existing prohibitions against layering and spoofing with an expedited objective prohibition that will stop harmful manipulative activity while the Exchange conducts necessary extensive and time-consuming investigations and enforcement.'' [88] The Exchange reiterates that principles-based prohibitions of layering and spoofing already exist and explains, however, that investigations of ''principles-based'' rules violations involving suspected layering and spoofing conduct are lengthy due to the fact that enforcement of those violations requires proof of subjective fraudulent intent of the actor, which the Exchange states is ''usually very difficult to prove and requires a thorough and lengthy investigation and enforcement process.'' [89] The Exchange asserts that, during the course of such an investigation, it does not currently have the ability to stop obvious and flagrant manipulative trading.[90] The Exchange states that if the current proposal is ultimately approved and implemented, the Exchange will continue conducting its current enforcement process, and represents that it would only seek an expedited suspension when—after multiple requests to a Member for an explanation of activity—it continues to see the same pattern of manipulation from the same Member and the source of the activity is the same or has been previously identified as a frequent source of disruptive quoting and trading activity.[91] Therefore, according to the Exchange, principles-based enforcement and the proposed rule change are complementary in practice, not mutually exclusive.[92]

In response to the Exchange's letter, the commenter submitted an additional comment, in which the commenter states that the Exchange misread certain its criticisms of the current proposal.[93] The commenter cites to the Exchange's statement in the Exchange's response letter that the commenter ''advocates that the Exchange *must* adopt 'principle-based' language *instead* of the Exchange's current proposal.'' [94] Rather, according to the commenter, its position is that the Commission should require the Exchange ''to *also* include in its rulebook a clearly articulated principle rather than *only* a prescriptive checklist, particularly when so far as [the commenter] can tell [the Exchange] hasn't yet independently detected the proscribed behavior on its markets and hasn't documented any current enforcement proceedings its proposal could expedite in the future.'' [95] In addition, this commenter asserts that the Exchange misinterpreted its point regarding past cases of improper quoting and trading activity that the Exchange cites as support for the proposal; the commenter asserts that its point is that those are not cases in which the Exchange independently discovered the violative layering or spoofing conduct at issue.[96]

Expedited Suspension Proceedings Under Proposed Rule 8.17

One commenter that was supportive of BATS–2015–57 believed that the Exchange's proposed investigation, notice, and hearing processes described in connection with proposed Rule 8.17 under BATS–2015–57 were reasonable.[97] This commenter also suggested that the Exchange could amend proposed Rule 8.17 to require a lower burden of proof in Expedited Client Suspension Proceedings, which the commenter asserted would still allow the Exchange to institute a process to quickly put a stop to the manipulative behavior targeted by the proposal ''without drastically expanding the Exchange's definition of prohibited layering and spoofing to include completely unintentional conduct.'' [98]

Another commenter criticized the procedural components of the proposed rules as set forth in BATS–2015–57.[99] The commenter argued that the Exchange has no jurisdiction to compel Members to deny access to clients that the Exchange judges to have been involved in layering or spoofing, and that such affected clients would be denied due process as they are not entitled to be heard as part of the Expedited Client Suspension Proceeding.[100] In response to this argument, in its first response letter, the Exchange stated that its rules ''unquestionably confer jurisdiction to the Exchange to discipline its Members for a Member's client's violations of the Act and the Exchange's Rules,'' [101] and the Exchange referenced Rule 8.1 in this regard.[102] The Exchange further stated that ''jurisdiction over a Member for a client's actions is not only permissible—it is essential for the effective regulation of the Exchange.'' [103] The Exchange also asserted that, because a Member has ultimate responsibility for its clients' actions and because proposed Rule 8.17 imposes discipline on a Member—not its client—for the client's violations, it is sufficient if due process is afforded to the Member.[104] The Exchange noted, however, that nothing in the proposal prevents a Member's client from participating in an expedited suspension hearing and, in fact, the Exchange stated that it would welcome such participation at the hearing.[105]

The same commenter also argued that the proposed expedited proceeding set forth in BATS–2015–57 was not a fair disciplinary process under the Act because it did not provide adequate time for discovery.[106] In response to this point, the Exchange contended that the proposed expedited client suspension hearing is governed by and consistent with Section 6(d)(2) of the Act and, therefore, provides the due process required by the Act.[107] In addition, the Exchange noted that it intends to initiate such a proceeding only after an initial investigation into the allegedly improper trading activity, including contacting the responsible member to request an explanation for the activity and any relevant additional information.[108] Further, the Exchange noted that discovery would continue after the entry of a suspension order, and that, under proposed Rule 8.17, a Member subject to a suspension order

[87] *See* BATS Response Letter II, *supra* note 8, at 9 n.9.

[88] *Id.*

[89] *Id.* at 8–9.

[90] *Id.* at 8.

[91] *Id.* at 6, 8–9. The Exchange explains that, currently, when Exchange surveillance staff identifies a pattern of potentially disruptive quoting and trading activity, the staff conducts an initial analysis and investigation of that activity. *Id.* After the initial investigation, the Exchange then contacts the Member responsible for the orders that caused the activity to request an explanation of the activity as well as any additional relevant information, including the source of the activity. *Id.* The Exchange represents that it will continue this practice if the Commission approves the proposal. *Id.*

[92] *Id.* at 9.

[93] *See* Leuchtkafer Letter III, *supra* note 8, at 2. *See also* Leuchtkafer Letter II, *supra* note 8.

[94] *See* Leuchtkafer Letter III, *supra* note 8, at 2 (emphasis in original).

[95] *Id.* (emphasis in original).

[96] *Id.* at 1.

[97] *See* FIA Letter, *supra* note 8, at 2.

[98] *Id.* at 4.

[99] *See* Lek Letter I, *supra* note 8, at 6–7. This commenter also submitted a comment letter on the current proposal that repeats these criticisms, to which the Exchange responded by incorporating by reference the statements in its comment response letter for BATS–2015–57. *See* Lek Letter III, *supra* note 8, at 7–8; BATS Response Letter II, *supra* note 8, at 10.

[100] *See* Lek Letter I, *supra* note 8, at 6.

[101] *See* BATS Response Letter I, *supra* note 8, at 8–9.

[102] *Id.* at 9. *See also* Rule 8.1 (setting forth the Exchange's disciplinary jurisdiction).

[103] *See* BATS Response Letter I, *supra* note 8, at 9.

[104] *Id.*

[105] *Id.*

[106] *See* Lek Letter I, *supra* note 8, at 6.

[107] *See* BATS Response Letter I, *supra* note 8, at 10.

[108] *Id. See also* BATS Response Letter II, *supra* note 8, at 6.

that discovers information that it believes to be exculpatory may apply at any time to the Hearing Panel to have the suspension order modified, set aside, limited, or revoked.[109] According to the Exchange, ''[p]roposed Rule 8.17 merely places the burden on the Subject Member to show that it has halted its harmful practice or its client's harmful practice before being permitted to resume activity on the Exchange rather than requiring the market to bear the harm of manipulative conduct during the time-consuming discovery process.'' [110]

Recommendation of the OIAD

As noted above, the OIAD submitted to the public comment file its recommendation to the Commission that the Commission approve this proposal.[111] In its recommendation, the OIAD states that it supports ''the Exchange's efforts to promptly initiate and quickly resolve obvious and uncomplicated matters the Exchange believes involve disruptive and manipulative trading activity.'' [112] The OIAD believes that ''[e]ven if limited to a small number of cases, such disruptive quoting and trading behavior can cause significant harm to investors and the markets'' and ''erode the public's confidence in fair and orderly markets.'' [113] The OIAD further believes that a disciplinary proceeding against a U.S.-based broker dealer that permits a significant volume of manipulative trading to pass through its systems on a regular basis without establishing a supervisory system reasonably designed to detect and prevent this activity ''must be timely.'' [114] The OIAD states that this proposal appears to be appropriately tailored to minimize the possibility that it would curtail legitimate trading activities by market makers and other liquidity providers, and that the proposed Expedited Client Suspension Proceeding appears to provide ''appropriate safeguards for innocent parties,'' such as adequate notice, an opportunity to be heard at a meaningful time prior to the decision, a right to appeal the determination, and a right to obtain Commission review.'' [115] Further, the OIAD believes that the proposed process should act as a deterrent to U.S. broker-dealers that would otherwise permit manipulators to continue to access U.S. markets during the course of an enforcement proceeding.[116] Accordingly, the OIAD submitted its recommendation to the Commission that the Commission approve the proposal.[117]

IV. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[118] In particular, the Commission finds that the proposed rule change is consistent with the requirements of: (1) Section 6(b)(1) of the Act,[119] which requires, among other things, that the Exchange be so organized and have the capacity to enforce compliance by its members and persons associated with its members with the Act, the rules thereunder, and the Exchange's rules; (2) Section 6(b)(5) of the Act,[120] which requires, among other things, that the Exchange's rules be 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; (3) Section 6(b)(6) of the Act,[121] which requires, among other things, that the Exchange's rules provide for appropriate discipline of members or persons associated with a member for violations of the Act, the rules thereunder, or the Exchange's rules; (4) Section 6(b)(7) of the Act,[122] which requires, among other things, that the rules of an exchange be in accordance with Section 6(d) of the Act,[123] and in general, provide a fair procedure for the disciplining of members and persons associated with members and the prohibition or limitation by the exchange of any person with respect to access to services offered by the exchange or a member thereof; and (5) Sections 6(d)(1) and 6(d)(2) of the Act,[124] which require, among other things, that in any Exchange proceeding to determine whether a member or person associated with a member should be disciplined or whether a person should be prohibited or limited with respect to access to services offered by the exchange or a member thereof, the Exchange must provide notice of, and an opportunity to be heard upon, the specific grounds for the sanction under consideration, keep a record, and provide a statement setting forth the specific grounds upon which a determination to impose any such sanction is based.

The Commission notes that the Exchange believes that the proposal meets the requirements of Sections 6(b)(1), 6(b)(5), and 6(b)(6) of the Act because it will provide the Exchange with a mechanism to promptly initiate proceedings in the event that the Exchange believes it has sufficient proof that a violation of proposed Rule 12.15 is occurring, and also because it will help to strengthen the Exchange's ability to carry out its oversight and enforcement responsibilities as a self-regulatory organization in cases where awaiting the conclusion of a full disciplinary hearing is unsuitable in view of the potential harm to other members, their customers, and/or the Exchange that may occur if the violative conduct is allowed to continue.[125] The Exchange notes that it has defined the prohibited disruptive quoting and trading activities by modifying the traditional definitions of layering and spoofing to eliminate an express intent element.[126] The Exchange states that it believes it is necessary for the protection of investors to make such modifications to those traditional definitions in order to adopt an expedited process rather than allowing disruptive quoting and trading activities to continue to occur for a potentially extended period of time.[127] The Exchange also states that it does not intend for this proposal to modify the definitions of layering and spoofing that have generally been used by the Exchange and other regulators in connection with prior disciplinary and enforcement cases.[128]

The Commission further notes that the Exchange already has the authority pursuant to its existing rules to prohibit and take action against manipulative trading activity, including the disruptive quoting and trading activities

[109] *See* BATS Response Letter I, *supra* note 8, at 10.

[110] *Id.*

[111] *See supra,* note 9.

[112] *See* OIAD Recommendation, *supra* note 9, at 3.

[113] *Id.* at 4.

[114] *Id.* at 5.

[115] *Id.* at 6.

[116] *Id.* at 5–6. In its letter addressing the current proposal, the Exchange explains that the OIAD ''correctly notes that the proposed expedited suspension process is intended to be used sparingly as a deterrent force—supplementing rather than replacing the current enforcement process.'' *See* BATS Response Letter II, *supra* note 8, at 7.

[117] *See* OIAD Recommendation, *supra* note 9, at 3.

[118] In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[119] 15 U.S.C. 78f(b)(1).

[120] 15 U.S.C. 78f(b)(5).

[121] 15 U.S.C. 78f(b)(6).

[122] 15 U.S.C. 78f(b)(7).

[123] 15 U.S.C. 78f(d).

[124] 15 U.S.C. 78f(d)(1), (d)(2).

[125] *See* Notice, *supra* note 5, at 73251.

[126] *Id.*

[127] *Id.*

[128] *Id.*

enumerated under proposed Rule 12.15.[129] Violations of these rules, however, are pursued according to the Exchange's existing disciplinary and enforcement processes which, as the Exchange describes, can take several years to conclude, during which time the manipulative or disruptive quoting or trading activity may continue to the detriment of investors and other market participants.[130] The Commission acknowledges that good reason exists in many cases for these lengthy processes, not the least of which is ensuring that adequate due process is provided. However, if an offending Member refuses to cease disruptive quoting and trading activity that is enumerated in Rule 12.15 after the Exchange detects such activity and notifies the Member of the alleged misconduct, the Commission also believes that it would be consistent with the Act for the Exchange to have the authority to seek to stop that disruptive quoting and trading activity through the proposed expedited client suspension proceeding. The Commission believes that the disciplinary procedures proposed herein are reasonably designed to occur on an expedited basis in order stop two specific types of ongoing disruptive quoting and trading activities that the Exchange believes could result in significant harm to investors if allowed to continue. Accordingly, the Commission believes that the proposal is reasonably designed to further the purposes of Sections 6(b)(1), 6(b)(5), and 6(b)(6) of the Act by enhancing the Exchange's ability to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, protect investors and the public interest, enforce compliance by its members and persons associated with its members with the relevant rules and law, and appropriately discipline its members for violations of the rules of the Exchange.

In addition, the Commission notes that the Exchange represents that it ''will only seek an expedited suspension when—after multiple requests to a Member for an explanation of [a pattern of potentially disruptive quoting and trading] activity—it continues to see the same pattern of manipulation from the same Member and the source of the activity is the same or has been previously identified as a frequent source of disruptive quoting and trading activity.'' [131] As such, the Commission believes that the disciplinary measures available to the Exchange under the proposal to stop the offending trading behavior from continuing on the Exchange—*i.e.,* an order suspending the offending Member unless the applicable action is taken or refrained from—are consistent with Section 6(b)(6) of the Act.

The Commission recognizes one commenter's concern that the definitions of the prohibited quoting and trading activities set forth in proposed Rule 12.15 could be viewed by some to be too narrow, such that certain other disruptive or manipulative trading activities might not fall within those definitions.[132] The Commission notes that, in making revisions to its original proposal in BATS–2015–57, the Exchange has purposely chosen to prohibit, under proposed Rule 12.15, two types of trading activities that follow very specific fact patterns, which the Exchange believes constitute clear and egregious disruptive quoting and trading activity. The Commission also notes that, according the Exchange, this proposal is not meant to define all possible permutations of layering and spoofing.[133] Rather, the Exchange asserts that the proposal is meant to provide the Exchange with an expedited disciplinary proceeding, to be used under limited circumstances, as a complement to its current, lengthier disciplinary process.[134] Accordingly, the Exchange has purposely chosen not to subject other types of disruptive or manipulative quoting or trading activities to the prohibitions of proposed Rule 12.15 or, therefore, the expedited disciplinary procedure under proposed Rule 8.17. That the Exchange has purposely proposed to apply these rules to some, but not all, types of disruptive quoting and trading activities does not render the proposed rules inconsistent with the Act. The Exchange may exercise its judgment as to the proper scope of its rules, so long as the rules comply with the relevant statutory requirements under the Act and the rules thereunder. In this instance, the Commission believes that it is consistent with the Act for the Exchange to limit the application of the Expedited Client Suspension Proceeding to a specific set of disruptive quoting and trading activities rather than to have the proposal encompass all types of disruptive or manipulative activities, which are still subject to the Exchange's standard disciplinary process.

Furthermore, given the significant authority provided to the Exchange under proposed Rule 8.17 for pursuing alleged violations of proposed Rule 12.15, the Commission believes that it is appropriate and consistent with the Act for proposed Rule 12.15 to be narrowly tailored so as to only encompass certain specific types of disruptive quoting and trading activities. Moreover, as noted by the OIAD, ''[e]ven if limited to a small number of cases, such disruptive quoting and trading behavior can cause significant harm to investors and the markets.'' [135] The Commission believes that, by prohibiting specific types of disruptive quoting and trading activities and providing an expeditious process for ceasing such activities, proposed Rules 12.15 and 8.17, respectively, are reasonably designed to protect investors and the public interest from the potential harm associated with such activities. Therefore, the Commission believes that the proposed rules are consistent with the requirements under Section 6(b)(5) that the Exchange's rules be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and protect investors and the public interest. In addition, the Commission again notes that any quoting or trading activity that does not fall within the express prohibitions of proposed Rule 12.15—but that is disruptive or manipulative—may be subject to existing disciplinary and enforcement measures if the activity constitutes a violation of one or more of the Exchange's current rules and/or the Act and the rules thereunder.

The Commission recognizes another concern of certain commenters that the proposed definitions of the prohibited disruptive quoting and trading activities may be too broad, such that they may encompass legitimate quoting or trading activity, such as market making. The Commission emphasizes the importance of the Exchange's acknowledgement that the authority conferred by proposed Rules 8.17 and 12.15 is a powerful measure that should be used very cautiously.[136] In addition, the Commission believes that the proposal incorporates procedural components that are reasonably designed to mitigate the potential for overreach of this authority into legitimate quoting or trading activity. For example, proposed Rule 8.17 would require the CRO or another senior officer of the Exchange to

[129] *See, e.g.,* Rules 3.1, 3.2, and 3.3. *See also* Notice, *supra* note 5, at 73250–51.

[130] *See* Notice, *supra* note 5, at 73248.

[131] *See* BATS Response Letter II, *supra* note 8, at 6.

[132] *See* Leuchtkafer Letters I, II, and III, *supra* note 8.

[133] *See* BATS Response Letter II, *supra* note 8, at 9 n.9.

[134] *See supra,* notes 87–92 and accompanying text.

[135] *See* OIAD Recommendation, *supra* note 9, at 4.

[136] *See* Notice, *supra* note 5, at 73251.

issue written authorization before the Exchange can institute an Expedited Client Suspension Proceeding. Additionally, the Commission believes that the opportunity to respond before a hearing panel, and the associated due process elements for initiating and conducting the expedited proceeding under proposed Rule 8.17, provide additional safeguards. Moreover, the Commission notes that a determination of the Hearing Panel constituting final disciplinary sanction may be appealed to the Commission pursuant to Section 19 of the Act.[137] The Commission also notes that the OIAD believes that the proposal ''appears to be appropriately tailored to minimize the possibility that it would curtail legitimate trading activities by market makers and other liquidity providers'' and ''appears to provide appropriate safeguards for innocent parties.'' [138]

Lastly, the Commission notes that the Exchange believes that the requirements of Sections 6(b)(7), 6(d)(1), and 6(d)(2) of the Act are addressed by the notice and due process provisions included within proposed Rule 8.17.[139] Proposed Rule 8.17 would require the Exchange to serve notice on the subject Respondent, which notice would include the suspension order the Exchange seeks to impose on the Respondent. The notice would also be accompanied by a declaration of facts that specifies the acts that constitute the alleged violation. Proposed Rule 8.17 also would provide an opportunity for the Respondent to defend against the charges in the notice in a hearing before a three-person Hearing Panel,[140] with the opportunity for witnesses and with a transcribed record, and would detail the applicable timelines for the proceeding. Further, proposed Rule 8.17 would require the Hearing Panel to issue a written decision stating whether a suspension order shall be imposed; if imposed, proposed Rule 8.17 would require the suspension order to set forth the alleged violation and market disruption or significant harm to investors that is likely to result without the order, and to describe in reasonable detail what action the Respondent is required to take or refrain from taking. In addition, proposed Rule 8.17 would allow the Respondent to appeal to the Hearing Panel to have a suspension order modified, set aside, limited, or revoked. Accordingly, the Commission believes that proposed Rule 8.17 is consistent with Sections 6(b)(7), 6(d)(1), and 6(d)(2) of the Act.[141]

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[142] that the proposed rule change (SR–BATS–2015–101), as modified by Amendment No. 1, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[143]

Robert W. Errett,

Deputy Secretary.

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[137] 15 U.S.C. 78s. *See also* proposed Rule 8.17(f).

[138] *See* OIAD Recommendation, *supra* note 9, at 6.

[139] *See* Notice, *supra* note 5, at 73251.

[140] The Commission notes that the Hearing Panel would be assigned according to current Rule 8.6(a), which requires that one member of the panel be a professional hearing officer, another be an industry representative, and the third be a Member representative.

[141] 15 U.S.C. 78f(b)(7), (d)(1), and (d)(2).

[142] 15 U.S.C. 78s(b)(2).

[143] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–77169; File No. SR–NYSEARCA–2016–26]

Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Amending the NYSE Arca Schedule of Options Fees and Charges

February 18, 2016.

Pursuant to Section 19(b)(1) [1] of the Securities Exchange Act of 1934 (the ''Act'') [2] and Rule 19b–4 thereunder,[3] notice is hereby given that, on February 4, 2016, NYSE Arca, Inc. (the ''Exchange'' or ''NYSE Arca'') filed with the Securities and Exchange Commission (the ''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend the NYSE Arca schedule of Options Fees and Charges (''Fee Schedule'') to exclude from its average daily volume calculations any trading day on which the Exchange is not open for the entire trading day and/or a disruption affects an Exchange system that lasts for more than 60 minutes during regular trading hours. The Exchange proposes to implement the fee change effective February 4, 2016. The proposed rule change is available on the Exchange's Web site at *www.nyse.com*, at the principal office of the Exchange, and at the Commission's Public Reference Room.

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

In its filing with the Commission, the self-regulatory organization 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 those 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend its Fee Schedule to exclude from its average daily volume (''ADV'') calculations any trading day on which (1) the Exchange is not open for the entire trading day and/or (2) a disruption affects an Exchange system that lasts for more than 60 minutes during regular trading hours. The Exchange proposes to implement the fee change effective February 4, 2016.

As provided in the Exchange's Fee Schedule, several of the Exchange's transaction fees and credits are based on trading, quoting and liquidity thresholds that involve an ADV calculation. The Exchange proposes to add a clause permitting the Exchange to exclude from its ADV calculation, when determining the qualification threshold for electronic customer executions that take liquidity in a non-Penny Pilot class from the trading interest of an Lead Market Maker (''LMM'') (including orders and quotes) and for applicable rebate tiers generally, contracts traded on any day on which the Exchange is not is not [sic] open for the entire trading day. This would allow the Exchange to exclude days where the Exchange declares a trading halt in all securities or honors a market-wide trading halt declared by another market as well as days on which the market closes early for holiday observances. The Exchange's proposal is consistent

[1] 15 U.S.C.78s(b)(1).

[2] 15 U.S.C. 78a.

[3] 17 CFR 240.19b–4.