

# Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Part 230

[Release No. 33-9251; File No. S7-31-11]

RIN 3235-AL20

### Covered Securities Pursuant to Section 18 of the Securities Act of 1933

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** The Securities and Exchange Commission ("SEC" or "Commission") proposes for comment an amendment to Rule 146 under Section 18 of the Securities Act of 1933 ("Securities Act"), as amended, to designate certain securities on BATS Exchange, Inc. ("BATS" or "Exchange") as covered securities for purposes of Section 18 of the Securities Act. Covered securities under Section 18 of the Securities Act are exempt from state law registration requirements.

**DATES:** Comments should be received on or before September 12, 2011.

**ADDRESSES:** Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-31-11 on the subject line.
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### Paper Comments

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

All submissions should refer to File Number S7-31-11. 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 Web site (<http://www.sec.gov/rules/proposed.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 a.m. and 3 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** David R. Dimitriou, Senior Special Counsel, (202) 551-5131, Ronessa Butler, Special Counsel, (202) 551-5629 or Carl Tugberk, Special Counsel, (202) 551-6049, Division of Trading and Markets ("Division"), Commission, 100 F Street, NE., Washington, DC 20549-6628.

#### SUPPLEMENTARY INFORMATION:

##### I. Introduction

In 1996, Congress amended Section 18 of the Securities Act to exempt from state registration requirements securities listed, or authorized for listing, on the New York Stock Exchange LLC ("NYSE"), the American Stock Exchange LLC ("Amex") (now known as NYSE Amex LLC),<sup>1</sup> or the National

<sup>1</sup> On October 1, 2008, NYSE Euronext acquired The Amex Membership Corporation ("AMC") pursuant to an Agreement and Plan of Merger, dated January 17, 2008 (the "Merger"). In connection with the Merger, NYSE Amex's predecessor, the Amex, a subsidiary of AMC, became a subsidiary of NYSE Euronext called NYSE Alternext US LLC ("NYSE Alternext"). See Securities Exchange Act Release No. 58673 (September 29, 2008), 73 FR 57707 (October 3,

Market System of The NASDAQ Stock Market LLC ("Nasdaq/NGM")<sup>2</sup> (collectively, the "Named Markets"), or any national securities exchange designated by the Commission to have substantially similar listing standards to those of the Named Markets.<sup>3</sup> More specifically, Section 18(a) of the Securities Act provides that "no law, rule, regulation, or order, or other administrative action of any State \* \* \* requiring, or with respect to, registration or qualification of securities \* \* \* shall directly or indirectly apply to a security that—(A) is a covered security."<sup>4</sup> Covered securities are defined in Section 18(b)(1) of the Securities Act to include those securities listed, or authorized for listing, on the Named Markets, or securities listed, or authorized for listing, on a national securities exchange (or tier or segment thereof) that has listing standards that the Commission determines by rule are "substantially similar" to those of the Named Markets ("Covered Securities").<sup>5</sup>

Pursuant to Section 18(b)(1)(B) of the Securities Act, the Commission adopted Rule 146.<sup>6</sup> Rule 146(b) lists those

2008) (SR-NYSE-2008-60 and SR-Amex-2008-62) (approving the Merger). In 2009, the Exchange changed its name from NYSE Alternext to NYSE Amex LLC ("NYSE Amex"). See Securities Exchange Act Release No. 59575 (March 13, 2009), 74 FR 11803 (March 19, 2009) (SR-NYSEALTR-2009-24) (approving the name change).

<sup>2</sup> As of July 1, 2006, the National Market System of The NASDAQ Stock Market LLC is known as the Nasdaq Global Market ("NGM"). See Securities Exchange Act Release Nos. 53799 (May 12, 2006), 71 FR 29195 (May 19, 2006) and 54071 (June 29, 2006), 71 FR 38922 (July 10, 2006).

<sup>3</sup> See National Securities Markets Improvement Act of 1996, Pub. L. 104-290, 110 Stat. 3416 (October 11, 1996).

<sup>4</sup> 15 U.S.C. 77r(a).

<sup>5</sup> 15 U.S.C. 77r(b)(1)(A) and (B). In addition, securities of the same issuer that are equal in seniority or senior to a security listed on a Named Market or national securities exchange designated by the Commission as having substantially similar listing standards to a Named Market are covered securities for purposes of Section 18 of the Securities Act. 15 U.S.C. 77r(b)(1)(C).

<sup>6</sup> Securities Exchange Act Release No. 39542 (January 13, 1998), 63 FR 3032 (January 21, 1998) (determining that the listing standards of the Chicago Board Options Exchange, Incorporated ("CBOE"), Tier 1 of the Pacific Exchange, Inc. ("PCX") (now known as NYSE Arca, Inc.), and Tier 1 of the Philadelphia Stock Exchange, Inc. ("Phlx") (now known as NASDAQ OMX PHLX LLC) were substantially similar to those of the Named Markets and that securities listed pursuant to those standards would be deemed Covered Securities for purposes of Section 18 of the Securities Act). In 2004, the Commission amended Rule 146(b) to designate options listed on the International Securities Exchange, Inc. ("ISE") (now known as

national securities exchanges, or segments or tiers thereof, that the Commission has determined to have listing standards substantially similar to those of the Named Markets and thus securities listed on such exchanges are deemed Covered Securities.<sup>7</sup> BATS has filed a proposed rule change for the listing of securities on BATS<sup>8</sup> and has petitioned the Commission to amend Rule 146(b) to designate such securities as Covered Securities for the purpose of Section 18 of the Securities Act.<sup>9</sup> If the Commission were to approve the proposed listing standards and make this determination, then securities listed on BATS would be exempt from state law registration requirements.<sup>10</sup> Additionally, should the Commission approve BATS' proposed listing standards and the securities listed, or authorized for listing, on BATS were designated as Covered Securities under Rule 146(b)(1), then BATS' listing standards would be subject to Rule 146(b)(2) under the Securities Act. Rule 146(b)(2) conditions the designation of securities as Covered Securities under Rule 146(b)(1) on the identified exchange's listing standards continuing to be substantially similar to those of the Named Markets. Thus, under Rule 146(b)(2), the designation of certain securities as Covered Securities would be conditioned on BATS maintaining listing standards for its equity securities that are substantially similar to those of the Named Markets.

## II. Background

In 1998, the CBOE, PCX (now known as NYSE Arca, Inc.), Phlx,<sup>11</sup> and the Chicago Stock Exchange, Inc. ("CHX") petitioned the Commission to adopt a

rule determining that specified portions of the exchanges' listing standards were substantially similar to the listing standards of the Named Markets.<sup>12</sup> In response to the petitions, and after extensive review of the petitioners' listing standards, the Commission adopted Rule 146(b), determining that the listing standards of the CBOE, Tier 1 of the PCX, and Tier 1 of the Phlx were substantially similar to those of the Named Markets and that securities listed pursuant to those standards would be deemed Covered Securities.<sup>13</sup> In 2004, ISE petitioned the Commission to amend Rule 146(b) to determine that its listing standards for securities listed on ISE are substantially similar to those of the Named Markets and, accordingly, that securities listed pursuant to such listing standards are Covered Securities for purposes of Section 18(b) of the Securities Act.<sup>14</sup> The Commission subsequently amended Rule 146(b) to designate options listed on ISE as Covered Securities.<sup>15</sup> In 2007, Nasdaq petitioned the Commission to amend Rule 146(b) to determine that listing standards for securities listed on the NCM are substantially similar to those of the Named Markets and, accordingly, that securities listed pursuant to such listing standards are Covered Securities.<sup>16</sup> The Commission subsequently amended Rule 146(b) to designate securities listed on the NCM as Covered Securities.<sup>17</sup>

BATS has petitioned the Commission to amend Rule 146(b) and determine that its proposed listing standards for securities listed on BATS are substantially similar to those of the Named Markets, and that such securities

are Covered Securities under Section 18(b) of the Securities Act.<sup>18</sup>

## III. Discussion

Under Section 18(b)(1)(B) of the Securities Act,<sup>19</sup> the Commission has the authority to determine that the listing standards of an exchange, or tier or segment thereof, are substantially similar with those of the NYSE, NYSE Amex, or Nasdaq/NGM. The Commission initially has compared BATS' proposed listing standards for all securities with one of the Named Markets. If the proposed listing standards in a particular category were not substantially similar to the standards of that market, the Commission compared BATS' proposed standards to one of the other two markets.<sup>20</sup> In addition, as it has done previously, the Commission has interpreted the "substantially similar" standard to require listing standards at least as comprehensive as those of the Named Markets.<sup>21</sup> If a petitioner's listing standards are higher than the Named Markets, then the Commission may still determine that the petitioner's listing standards are substantially similar to those of the Named Markets.<sup>22</sup> Finally, the Commission notes that differences in language or approach would not necessarily lead to a determination that the listing standards of the petitioner are not substantially similar to those of any Named Market.<sup>23</sup>

The Commission has reviewed proposed listing standards for securities to be listed and traded on BATS and, for the reasons discussed below, preliminarily believes that the proposed standards overall are substantially similar to those of a Named Market.<sup>24</sup>

### A. Qualitative Listing Standards

BATS' proposed qualitative listing standards for both the Tier I and Tier II securities are substantively identical to

the International Securities Exchange, LLC) as Covered Securities for purposes of Section 18(b) of the Securities Act. See Securities Act Release No. 8442 (July 14, 2004), 69 FR 43295 (July 20, 2004). In 2007, the Commission amended Rule 146(b) to designate securities listed on the Nasdaq Capital Market ("NCM") as Covered Securities for purposes of Section 18(b) of the Securities Act. See Securities Act Release No. 8791 (April 18, 2007), 72 FR 20410 (April 24, 2007).

<sup>7</sup> 17 CFR 230.146(b).

<sup>8</sup> See Securities Exchange Act Release No. 64546 (May 25, 2011), 76 FR 31660 (June 1, 2011) (proposing qualitative and quantitative listing requirements and standards for securities).

<sup>9</sup> See letter from Eric Swanson, Senior Vice President and General Counsel, BATS, to Elizabeth M. Murphy, Secretary, Commission, dated May 26, 2011 (File No. 4-632) ("BATS Petition").

<sup>10</sup> 15 U.S.C. 77r.

<sup>11</sup> On July 24, 2008, The NASDAQ OMX Group, Inc. acquired Phlx and renamed it "NASDAQ OMX PHLX LLC." See Securities Exchange Act Release Nos. 58179 (July 17, 2008), 73 FR 42874 (July 23, 2008) (SR-Phlx-2008-31); and 58183 (July 17, 2008), 73 FR 42850 (July 23, 2008) (SR-NASDAQ-2008-035). See also Securities Exchange Act Release No. 62783 (August 27, 2010), 75 FR 54204 (September 3, 2010) (SR-Phlx-2010-104).

<sup>12</sup> See letter from David P. Semak, Vice President, Regulation, PCX, to Arthur Levitt, Jr., Chairman, Commission, dated November 15, 1996; letter from Alger B. Chapman, Chairman, CBOE, to Jonathan G. Katz, Secretary, Commission, dated November 18, 1996; letter from J. Craig Long, Esq., Foley & Lardner, Counsel to CHX, to Jonathan G. Katz, Secretary, Commission, dated February 4, 1997; and letter from Michele R. Weisbaum, Vice President and Associate General Counsel, Phlx, to Jonathan G. Katz, Secretary, Commission, dated March 31, 1997.

<sup>13</sup> Securities Exchange Act Release No. 39542, *supra* note 6. The Commission did not include Tier 1 of the CHX in Rule 146 because of "concerns regarding the CHX's listing and maintenance procedures." *Id.* at 3032.

<sup>14</sup> See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Jonathan G. Katz, Secretary, Commission, dated October 9, 2003.

<sup>15</sup> Securities Act Release No. 8442 (July 14, 2004), 69 FR 43295 (July 20, 2004).

<sup>16</sup> See letter from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq, to Nancy M. Morris, Secretary, Commission, dated March 1, 2006 (File No. 4-513).

<sup>17</sup> See Securities Act Release No. 8791, *supra* note 6.

<sup>18</sup> See BATS Petition, *supra* note 9.

<sup>19</sup> 15 U.S.C. 77r(b)(1)(B).

<sup>20</sup> This approach is consistent with the approach that the Commission has previously taken. See Securities Act Release No. 7494 (January 13, 1998), 63 FR 3032 (January 21, 1998).

<sup>21</sup> See *id.*

<sup>22</sup> See Securities Act Release No. 8791, *supra* note 6.

<sup>23</sup> *Id.*

<sup>24</sup> See generally proposed BATS Chapter XIV; Securities Exchange Act Release No. 64546, *supra* note 8, 76 FR 31660. In making its preliminary determination of substantial similarity, as discussed in detail below, the Commission generally compared BATS' proposed qualitative listing standards for both Tier I and Tier II securities with Nasdaq/NGM's qualitative listing standards, BATS' proposed quantitative listing standards for Tier I securities with Nasdaq/NGM's quantitative listing standards, and BATS' proposed quantitative listing standards for Tier II securities with NYSE Amex's quantitative listing standards.

the qualitative listing standards for Nasdaq/NGM securities.<sup>25</sup> Therefore, the Commission preliminarily believes that BATS' qualitative listing standards for Tier I and Tier II securities are substantially similar to a Named Market.

The Commission requests comment on whether BATS' proposed qualitative listing standards for Tier I and Tier II are "substantially similar" to Nasdaq/NGM's listing standards.

### B. Tier I Securities Quantitative Listing Standards

The Commission believes that BATS' proposed initial and continued listing standards for its Tier I Securities are substantively identical to the initial and continued listing standards for securities listed on Nasdaq/NGM.<sup>26</sup> Therefore, the Commission preliminarily believes that BATS' quantitative listing standards for Tier I Securities are substantially similar to a Named Market.

The Commission requests comment on whether BATS' proposed Tier I Securities quantitative listing rules are "substantially similar" to Nasdaq/NGM's listing rules.

### C. Tier II Securities Quantitative Listing Standards

#### 1. Primary Equity Securities

The Commission compared BATS' proposed listing standards for primary equity securities listed on Tier II of the Exchange to the listing standards of NYSE Amex.<sup>27</sup> The Commission preliminarily believes that BATS' proposed initial listing standards for primary equity securities listed on Tier II of the Exchange are substantially similar to those of NYSE Amex's common stock listing standards.<sup>28</sup>

<sup>25</sup> Such qualitative listing standards relate to, among other things, the number of independent directors required, conflicts of interest, composition of the audit committee, executive compensation, shareholder meeting requirements, voting rights, quorum, code of conduct, proxies, shareholder approval of certain corporate actions, and the annual and interim reports requirements. *Compare* proposed BATS Rules 14.6 and 14.10 with Nasdaq Rule 5250 and Rule 5600 Series.

<sup>26</sup> *Compare* proposed BATS Rules 14.4(a) and 14.8 with Nasdaq Rule 5225(a) and Nasdaq Rule 5400 Series (providing for identical rules concerning initial listing and maintenance standards for units, primary equity securities, preferred stock and secondary classes of common stock, rights, warrants and convertible debt on BATS and the Nasdaq/NGM).

<sup>27</sup> See generally Sections 101 and 102 of the NYSE Amex Company Guide and proposed BATS Rule 14.9.

<sup>28</sup> BATS' proposed use of "primary equity securities" and NYSE Amex's use of "common stock" is simply a difference in nomenclature, as BATS' proposed listing standards define "primary equity security" as a company's first class of common stock. See proposed BATS Rule 14.1(a)(21).

Specifically, BATS' proposed requirements relating to bid price,<sup>29</sup> round lot holders,<sup>30</sup> shares held by the public,<sup>31</sup> and required number of registered and active market makers<sup>32</sup> are substantially similar to NYSE Amex requirements. Additionally, BATS'

<sup>29</sup> BATS' proposed listing standards would require a minimum bid price of \$4 per share for initial listing and \$1 per share for continued listing while NYSE Amex requires a minimum bid price of \$2–\$3 per share depending on the issuer for initial listing and will consider delisting if the price per share is "low." *Compare* proposed BATS Rule 14.9(b)(1)(A) with Section 102 of the NYSE Amex Company Guide. The Commission has interpreted the substantially similar standard to require listing standards at least as comprehensive as those of the Named Markets; the Commission may determine that a petitioner's standards are substantially similar if they are higher, and differences in language or approach of the listing standards are not dispositive. See *supra* notes 21–23 and accompanying text.

<sup>30</sup> While BATS' proposed listing standards would require at least 300 round lot holders, NYSE Amex's listing standards require 400 or 800 public shareholders (depending upon the number of shares held by the public), or 300 or 600 public shareholders for its alternate listing standards. The Commission preliminarily does not believe this difference would preclude a determination of substantial similarity between the standards. Additionally, BATS' proposed listing standards are identical to the listing standards of NCM, which the Commission previously found to be substantially similar to a Named Market. See Securities Act Release 8791, *supra* note 6 (determining that NCM listing standards, which are identical to BATS' proposed listing standards for primary equity securities on Tier II of the Exchange, are substantially similar to these same Amex standards). With respect to NCM having alternative listing standards for the number of round lot holders, the Commission noted that this difference did not preclude a determination of substantial similarity between the standards. See Securities Act Release 8791, *supra* note 6, 72 FR at 20412; Securities Act Release No. 8754 (November 22, 2006), 71 FR 67762 (November 22, 2006) (proposing that the Commission amend Rule 146(b) to designate securities listed on the NCM as covered securities for purposes of Section 18(b) of the Securities Act).

<sup>31</sup> BATS' proposed listing standards would require a minimum of 1,000,000 publicly held shares while NYSE Amex requires a minimum of 500,000. *Compare* proposed BATS Rule 14.9(b)(1)(B) with Section 102(a) of the NYSE Amex Company Guide. The Commission has interpreted the substantially similar standard to require listing standards at least as comprehensive as those of the Named Markets; the Commission may determine that a petitioner's standards are substantially similar if they are higher, and differences in language or approach of the listing standards are not dispositive. See *supra* notes 21–23 and accompanying text.

<sup>32</sup> BATS' proposed listing requirements would require at least three registered and active market makers while NYSE Amex requires one specialist to be assigned. *Compare* proposed BATS Rule 14.9(b)(1)(D) with Section 202(e) of the NYSE Amex Company Guide. The Commission may still determine that the petitioner's listing standards are substantially similar to those of the Named Markets if a petitioner's listing standards are higher than the Named Markets. See Securities Act Release No. 8791, *supra* note 6.

proposed equity,<sup>33</sup> market value,<sup>34</sup> and net income<sup>35</sup> standards are also substantially similar to NYSE Amex standards.

In addition to the above initial listing requirements, BATS would require that American Depositary Receipts ("ADRs") comply with an additional criterion. Specifically, BATS would require there be at least 400,000 ADRs issued for such securities to be initially listed on BATS.<sup>36</sup> However, NYSE Amex does not have specific requirements for ADRs in addition to its initial listing standards for primary equity securities.<sup>37</sup> As noted above, the Commission may still determine that the petitioner's listing standards are similar to those of the Named Markets if BATS' proposed listing standards are higher than the Named Markets.<sup>38</sup> The Commission preliminarily believes that BATS' proposed listing requirements for ADRs are substantially similar to those of NYSE Amex.

The Commission also preliminarily believes that the proposed continued listing requirements for primary equity securities listed on Tier II of the Exchange, while not identical, are substantially similar to those of NYSE Amex.<sup>39</sup> NYSE Amex's delisting criteria are triggered by poor financial conditions or operating results of the

<sup>33</sup> BATS' proposed listing standard would require a company to have stockholder equity of at least \$5 million, a market value of publicly held shares of at least \$15 million, and a two-year operating history. See proposed BATS Rule 14.9(b)(2)(A). NYSE Amex requires stockholder equity of at least \$4 million, a market value of publicly held shares of at least \$15 million, and a two-year operating history.

<sup>34</sup> BATS' proposed listing standards would require a market value of listed securities of at least \$50 million and a market value of publicly held shares of at least \$15 million, which is the same as required by NYSE Amex. *Compare* proposed BATS Rule 14.9(b)(2)(B) with Section 101(c)(2)–(3) of the NYSE Amex Company Guide.

<sup>35</sup> BATS' proposed listing standards would require net income from continuing operations of at least \$750,000, which is the same as required by NYSE Amex. *Compare* proposed BATS Rule 14.9(b)(2)(C) with Section 101(d)(1) of the NYSE Amex Company Guide.

<sup>36</sup> See proposed BATS Rule 14.9(b)(1)(E). This proposed requirement is identical to NCM. See Nasdaq Rule 5505(a)(5); see generally Securities Act Release 8791, *supra* note 6 (determining that NCM listing standards, which are identical to BATS' proposed standards for primary equity securities on Tier II of the Exchange, are substantially similar to the Amex standards).

<sup>37</sup> See Section 102 of the NYSE Amex Company Guide. See also Section 110 of the NYSE Amex Company Guide.

<sup>38</sup> See Securities Act Release No. 8791, *supra* note 6.

<sup>39</sup> See generally Securities Act Release 8791, *supra* note 6 (determining that NCM continued listing standards, which are identical to BATS' proposed continued listing standards for primary equity securities on Tier II of the Exchange, are substantially similar to the Amex standards).

issuer.<sup>40</sup> Specifically, NYSE Amex will consider delisting an equity issue if: (i) Stockholders' equity is less than \$2 million and such issuer has sustained losses from continuing operations and/or net losses in two of its three most recent fiscal years; (ii) stockholders' equity is less than \$4 million and such issuer has sustained losses from continuing operations and/or net losses in three of its four most recent fiscal years; (iii) stockholders' equity is less than \$6 million if such issuer has sustained losses from continuing operations and/or net losses in its five most recent fiscal years; or (iv) the issuer has sustained losses which are so substantial in relation to its overall operations or its existing financial resources, or its financial condition has become so impaired that it appears questionable, in the opinion of the exchange, as to whether such company will be able to continue operations and/or meet its obligations as they mature.<sup>41</sup>

Although BATS would not have the same continued listing provisions for Tier II, BATS also would look at the financial condition and operating results of the issuer in order to determine whether to delist an issuer. BATS' continued listing standards for Tier II securities would require compliance with either a (1) Shareholder equity, (2) market value of listed securities or (3) net income standard. Specifically, for continued listing, BATS would require shareholder's equity of at least \$2.5 million, market value of listed securities of at least \$35 million, or net income of \$500,000 from continuing operations in the past fiscal year or two out of three

past fiscal years.<sup>42</sup> Further, BATS would require an issuer to have (i) A minimum bid price for continued listing of \$1 per share,<sup>43</sup> (ii) at least two registered and active market makers, (iii) 300 public holders, and (iv) a minimum number of publicly held shares of at least 500,000 shares with a market value of at least \$1 million.<sup>44</sup> The Commission preliminarily believes that the differences in the maintenance criteria for common stock listed on NYSE Amex and as proposed on BATS for Tier II Securities are not significant and that, taken as a whole, the criteria are substantially similar.<sup>45</sup>

The Commission requests comment on whether BATS' proposed listing standards for primary equity securities on Tier II are "substantially similar" to NYSE Amex standards.

## 2. Preferred Stock and Secondary Classes of Common Stock

The Commission has compared the proposed listing standards of preferred stock and secondary classes of common stock on Tier II of the Exchange to the Nasdaq/NGM standards and preliminarily believes that BATS' standards are substantially similar to those of Nasdaq/NGM. A secondary class of common stock is a class of common stock of an issuer that has another class of common stock listed on an exchange.<sup>46</sup> The Commission

preliminarily believes that BATS' proposed initial and continued listing standards with respect to the number of round lot holders,<sup>47</sup> bid price,<sup>48</sup> number of publicly held shares,<sup>49</sup> market value of publicly held shares,<sup>50</sup> and number of market makers<sup>51</sup> are substantially similar to the Nasdaq/NGM standards.<sup>52</sup>

The Commission requests comment on whether the BATS proposed

<sup>47</sup> BATS' proposed initial listing standard would require 100 round lot holders, as Nasdaq/NGM requires. Compare proposed BATS Rule 14.9(c) with Nasdaq Rule 5510. Similarly, BATS' proposed continued listing standard would require 100 round lot holders. The Nasdaq/NGM continued listing standard requires 100 round lot holders. Compare proposed BATS Rule 14.9(f) with Nasdaq Rule 5460(a)(4).

<sup>48</sup> While BATS' proposed bid price requirement for initial listing is \$4 and the Nasdaq/NGM requirement is \$5, the Commission preliminarily does not believe this difference is significant. Compare proposed BATS Rule 14.9(c)(1)(A) with Nasdaq Rule 5510(a)(1). See also Securities Act Release No. 8791, *supra* note 6, at 20412 n. 28 (determining that an NCM bid requirement, which is identical to BATS' proposed bid requirement, was substantially similar to the Nasdaq/NGM requirement). Both BATS' proposed standard and Nasdaq/NGM's existing standard require a \$1 bid price for continued listing. Compare proposed BATS Rule 14.9(f)(1) with Nasdaq Rule 5460(a)(3).

<sup>49</sup> BATS' proposed standard would require 200,000 publicly held shares for initial listing, and 100,000 publicly held shares for continued listing, which is the same as Nasdaq/NGM requires. Compare proposed BATS Rule 14.9(c)(1)(C) and 14.9(f)(1)(c) with Nasdaq Rules 5415(a)(1) and 5460(a)(1).

<sup>50</sup> BATS' proposed standard for initial listing of preferred stock or a secondary class of common stock would require a market value of publicly held shares of at least \$3.5 million. Nasdaq/NGM requires a market value of publicly held shares of at least \$4 million. Compare proposed BATS Rule 14.9(c)(1)(D) with Nasdaq Rule 5415(a)(2). BATS' proposed standard for continued listing would require a market value of publicly held shares of at least \$1 million. Nasdaq/NGM requires a market value of publicly held shares of at least \$1 million for continued listing. Compare proposed BATS Rule 14.9(f)(1)(D) with Nasdaq Rule 5460(a)(1). The Commission preliminarily believes BATS' proposed initial and continued listing standards for preferred stock and secondary classes of common stock are substantially similar to Nasdaq/NGM. See also Securities Act Release No. 8791, *supra* note 6, at 20411–12. (determining that NCM listing standards, which are identical to BATS' proposed listing standards for preferred stock and secondary classes of common stock, are substantially similar to the Nasdaq/NGM standards).

<sup>51</sup> BATS proposed standard for initial listing would require at least three registered and active market makers, while its continued listing standard would require at least two registered and active market makers. Nasdaq/NGM requires the same. Compare proposed BATS Rule 14.9(c)(1)(E) with Nasdaq Rule 5415(a)(2).

<sup>52</sup> The Commission notes that these proposed requirements would apply to instances when the common stock or common stock equivalent security of the issuer were listed on BATS as a Tier II Security or otherwise were a Covered Security. If the common stock or common stock equivalent is not listed as a Tier II Security or is a Covered Security, then the security would be required to meet the initial primary equity listing requirements for Tier II noted above. Nasdaq/NGM contains a similar requirement. Compare proposed BATS Rule 14.9(f)(2) with Nasdaq Rule 5460(b).

<sup>40</sup> See generally Sections 1001 through 1006 of the NYSE Amex Company Guide.

<sup>41</sup> See Section 1003(a) of the NYSE Amex Company Guide. While not identical to NYSE Amex, BATS, as noted below, also has a shareholder equity standard. See *infra* note 42 and accompanying text. NYSE Amex, however, will not normally consider suspending dealing in (i) through (iii) noted above if the issuer is in compliance with the following: (1) Total market value of market capitalization of at least \$50,000,000; or total assets and revenue of \$50,000,000 each in its last fiscal year, or in two of its last three fiscal years; and (2) the issuer has at least 1,100,000 shares publicly held, a value of publicly held shares of at least \$15,000,000 and 400 round lot holders. *Id.*

NYSE Amex also will consider delisting if: (i) An issuer has sold or otherwise disposed of its principal operating assets or has ceased to be an operating company or has discontinued a substantial portion of its operations or business; (ii) if substantial liquidation of the issuer has been made; or (iii) if advice has been received, deemed by the Exchange to be authoritative, that the security is without value, or in the case of a common stock, such stock has been selling for a substantial period of time at a low price. See Section 1003(c) and (f)(v) of the NYSE Amex Company Guide.

<sup>42</sup> Proposed BATS Rule 14.9(e)(2)(A)–(C). NYSE Amex focuses on a shareholder equity standard for continued listing. BATS' proposed shareholder equity standard would require at least \$2.5 million shareholders' equity compared to NYSE Amex's lowest shareholder equity standard of \$2 million, if the NYSE Amex issuer has sustained losses from continuing operations and/or net losses in two of its three most recent fiscal years. Compare proposed BATS Rule 14.9(e)(2)(A)–(C) with Section 1003(a) of the NYSE Amex Company Guide.

<sup>43</sup> See proposed BATS Rule 14.9(e)(1)(B). Amex will consider delisting if the price per share is "low." See Section 1003(f)(v) of the Amex Company Guide. See also Securities Act Release 8791, *supra* note 6 (noting the same regarding the NCM and Amex bid price standards).

<sup>44</sup> Proposed BATS Rule 14.9(e)(1)(A)–(E). NYSE Amex will consider delisting the common stock of an issuer if the aggregate market value of such publicly held shares is less than \$1 million for more than 90 consecutive days, the number of publicly held shares is less than 200,000 shares, or the number of its public stockholders is less than 300. See Section 1003(b) of the NYSE Amex Company Guide.

<sup>45</sup> The Commission has interpreted the substantially similar standard to require listing standards at least as comprehensive as those of the Named Markets, and differences in language or approach of the listing standards are not dispositive. See *supra* notes 21–23 and accompanying text. See also Securities Act Release 8791, *supra* note 6 (determining that NCM continued listing standards, which are identical to BATS' proposed continued listing standards for primary equity securities on Tier II of the Exchange, are substantially similar to the Amex standards).

<sup>46</sup> See Securities Act Release No. 8791, *supra* note 6, at 20411.

secondary classes of common stock and preferred stock rules are “substantially similar” to Nasdaq/NGM’s rules.

### 3. Warrants

The Commission has compared BATS’ proposed standards for warrants to Nasdaq/NGM’s standards, and preliminarily believes that the BATS proposed standards are substantially similar to the Nasdaq/NGM standards. BATS’ proposed initial listing standards would require that 400,000 warrants be outstanding for initial listing, and that there be at least three registered and active market makers and 400 round lot holders.<sup>53</sup> Nasdaq/NGM’s standards are identical except that Nasdaq/NGM requires 450,000 warrants to be outstanding.<sup>54</sup> Though not identical with respect to the number of warrants outstanding standard, the Commission preliminarily believes these proposed initial listing standards are substantially similar to the Nasdaq/NGM standards.<sup>55</sup> Further, the proposed BATS standards would require the issuer’s underlying security to be listed on the Exchange or be a Covered Security.<sup>56</sup> The Commission notes that Nasdaq/NGM has a similar standard that the underlying security be listed on Nasdaq/NGM or be a Covered Security and preliminarily believes that BATS’ proposed standard is substantially similar to Nasdaq/NGM.<sup>57</sup>

The Commission also preliminarily believes that BATS’ proposed continuing listing requirements for warrants that there be two registered and active market makers (one of which may be a market maker entering a stabilizing bid) and that the underlying security remain listed on the Exchange or be a Covered Security are substantially similar to that of Nasdaq/NGM.<sup>58</sup>

The Commission requests comment on whether BATS’ proposed listing standards for warrants are “substantially similar” to Nasdaq/NGM’s listing standards.

### 4. Index Warrants

For index warrants traded on BATS, BATS has proposed the same standards (both initial and continuing) that apply to index warrants traded on Nasdaq/

NGM.<sup>59</sup> Therefore, the Commission preliminarily believes that the proposed listing standards for index warrants traded on BATS are substantially similar to the standards applicable to index warrants traded on the Nasdaq/NGM market.

The Commission requests comment on whether BATS proposed listing standards for index warrants are “substantially similar” to Nasdaq/NGM’s listing standards.

### 5. Convertible Debt

The Commission has compared BATS’ proposed listing standards for convertible debt to NYSE Amex’s listing standards for debt. The Commission preliminarily believes that BATS’ proposed initial listing standards regarding the threshold principal amount outstanding,<sup>60</sup> the availability of current last sale information,<sup>61</sup> and number of market makers<sup>62</sup> are substantially similar to NYSE Amex standards.<sup>63</sup> In addition to the

<sup>59</sup> Compare proposed BATS’ Rule 14.9(d)(3) with Nasdaq Rule 5725.

<sup>60</sup> The BATS proposed rule would require a principal amount outstanding of at least \$10 million for initial listing and \$5 million for continued listing. See proposed BATS Rule 14.9(d)(2)(A) and 14.9(g)(2)(A). NYSE Amex requires a principal amount outstanding of at least \$5 million for initial listing and will consider delisting if the principal amount outstanding is less than \$400,000 or if the issuer is not able to meet its obligations on the listed debt security. See Sections 104 and 1003 of the NYSE Amex Company Guide. As the Commission noted in a prior release, while these requirements are not identical, the Commission believes that both standards are designed to ensure the continued liquidity of the debt security, and thus are substantially similar. See Securities Act Release 8791, *supra* note 6, at 20412 (finding that an identical NCM listing standard was substantially similar to the Amex standard).

<sup>61</sup> Both BATS’ proposed standard and NYSE Amex include an initial listing requirement that there be current last sale information available in the United States with respect to the underlying security into which the bond or debenture is convertible. Compare proposed BATS Rule 14.9(d)(2)(B) with Section 104 of the NYSE Amex Company Guide. Additionally, Section 1003(e) of the NYSE Amex Company Guide states that convertible bonds will be reviewed when the underlying security is delisted and will be delisted when the underlying security is no longer the subject of real-time reporting in the United States. BATS’ continued listing standards for a convertible debt security also require that current last sale information be available in the United States with respect to the underlying security, whereas NYSE Amex does not. Compare proposed BATS Rule 14.9(g)(2)(C) with Section 1003(e) of the NYSE Amex Company Guide.

<sup>62</sup> BATS’ proposed standard would require at least three registered and active market makers for initial listing and two registered and active market makers for continued listing (one of which may be a market maker entering a stabilizing bid), whereas NYSE Amex requires one specialist to be assigned. Compare proposed BATS Rule 14.9(d)(1)(C) with NYSE Amex Rule 104.

<sup>63</sup> NYSE Amex will not list a convertible debt issue containing a provision which gives an issuer

requirements noted above, BATS’ proposed listing standards would require that one of four additional conditions be met for listing of convertible debt. Specifically, BATS proposes that it would not list a convertible debt security unless one of the following conditions were met: (i) The issuer of the debt security also has equity securities listed on the Exchange, NYSE Amex, the NYSE, or Nasdaq/NGM; (ii) an issuer of equity securities listed on the Exchange, NYSE Amex, the NYSE, or Nasdaq/NGM directly or indirectly owns a majority interest in, or is under common control with, the issuer of the debt security, or has guaranteed the debt security; (iii) a nationally recognized securities rating organization (an “NRSRO”) has assigned a current rating to the debt security that is no lower than an S&P Corporation “B” rating or equivalent rating by another NRSRO; or (iv) if no NRSRO has assigned a rating to the issue, an NRSRO has currently assigned an investment grade rating to an immediately senior issue or a rating that is no lower than an S&P Corporation “B” rating, or an equivalent rating by another NRSRO, to a *pari passu* or junior issue.<sup>64</sup> The Commission preliminarily believes that these other conditions proposed by BATS for listing of convertible debt are substantially similar to NYSE Amex standards.<sup>65</sup>

The Commission requests comment on whether the BATS proposed convertible debt listing rules are “substantially similar” to NYSE Amex’s listing standards for debt securities.

### 6. Units

The listing requirements for units on Tier II of the Exchange, NYSE Amex, and Nasdaq/NGM are all the same, as each evaluates the initial and continued listing of a unit by looking to its components.<sup>66</sup> If all of the components

discretion to reduce the conversion price unless the issuer establishes a minimum 10-day period within which such price reduction will be in effect. See Section 104 of the NYSE Amex Company Guide. The Commission preliminarily believes that omission of such a provision does not impact its determination. See Securities Act Release Nos. 39542, *supra* note 6 (finding PCX listing standards to be substantially similar to Amex even with the absence of this provision); 8791, *supra* note 6, at 20412 (finding NCM’s listing standard, which is identical to BATS’ proposed listing standard for convertible debt, is substantially similar to Amex even with the absence of this provision).

<sup>64</sup> These standards are identical to the initial listing standard for convertible debt securities on NYSE Amex and NCM. Compare proposed BATS Rule 14.9(d)(2)(D)(iv) with Section 104(A)–(E) of the NYSE Amex Company Guide and Nasdaq Rule 5515(b)(4).

<sup>65</sup> *Id.*

<sup>66</sup> A unit is a type of security consisting of two or more different types of securities (e.g., a

<sup>53</sup> See proposed BATS Rule 14.9(d)(1)(A), (C) and (D).

<sup>54</sup> See Nasdaq Rule 5410(a), (c) and (d).

<sup>55</sup> See also Securities Act Release 8791, *supra* note 6 (determining that NCM initial listing standards, which are identical to BATS’ proposed standards for warrants on Tier II of the Exchange, are substantially similar to the Amex standards).

<sup>56</sup> See BATS proposed Rule 14.9(d)(1)(B).

<sup>57</sup> See Nasdaq Rule 5410(b).

<sup>58</sup> Compare proposed BATS’ Rule 14.9(g)(1) with Nasdaq Rule 5455(1) and (2).

of a unit individually meet the standards for listing, then the unit would meet the standards for listing.<sup>67</sup> Because the components for units proposed by BATS are substantially similar to those of a Named Market, as discussed above, the Commission preliminarily believes that BATS' proposed listing standards for units to be listed on Tier II of the Exchange are substantially similar to a Named Market.<sup>68</sup>

The Commission requests comment on whether BATS' proposed listing standards for units on Tier II of the Exchange are "substantially similar" to NYSE Amex requirements.

#### *D. Other Securities Including Exchange Traded Funds, Portfolio Depository Receipts and Index Fund Shares*

In addition to the proposed listing standards for Tier I and Tier II securities and the analyses of such standards to the Named Markets discussed above, the Commission notes that BATS has proposed listing standards for other securities, including exchange traded funds, portfolio depository receipts, and index fund shares. The Commission also notes that BATS' proposed standards for these securities are identical to those of Nasdaq/NGM.<sup>69</sup>

#### *E. Other Changes*

Sections (b)(1) and (b)(2) of Rule 146 use the term "Amex" to refer to the American Stock Exchange LLC. As noted above, on October 1, 2008, NYSE Euronext acquired Amex and renamed it NYSE Alternext.<sup>70</sup> Further, in 2009, NYSE Alternext was renamed NYSE Amex LLC.<sup>71</sup> Additionally, Section (b)(1) of Rule 146 uses the term "the Philadelphia Stock Exchange, Inc." As noted above, on July 24, 2008, The NASDAQ OMX Group, Inc. acquired Phlx and renamed it "NASDAQ OMX PHLX LLC."<sup>72</sup> The proposed rule

change includes changes to Rule 146(b) to account for these name changes.

#### *F. Comments*

To date, the Commission has not received any comment letters on the Petition.

#### **IV. Solicitation of Comments**

The Commission seeks comment generally on the desirability of amending Rule 146(b) to include securities listed, or authorized for listing, of BATS. As discussed above, based on its review of BATS' proposed listing standards, the Commission preliminarily believes that the proposed initial and continued listing standards for BATS are substantially similar to those of the NYSE Amex or Nasdaq/NGM. The Commission seeks comments on its preliminary analysis.

The Commission also invites commenters to provide views and data as to the costs, benefits, and effects associated with the proposed amendments. In addition to the questions posed above, commenters are welcome to offer their views on any other matter raised by the proposed amendment to Rule 146(b), including the application of rule 146(b)(2). Finally, the Commission requests comment on whether it could use a different methodology to determine whether BATS' proposed listing standards are "substantially similar" to those of the Named Markets.

#### **V. Paperwork Reduction Act**

The Paperwork Reduction Act of 1995 does not apply because the proposed amendment to Rule 146(b) does not impose recordkeeping or information collection requirements or other collection of information, which require the approval of the Office of Management and Budget under 44 U.S.C. 3501 *et seq.*

#### **VI. Economic Analysis**

##### *A. Introduction*

Section 2(b) of the Securities Act<sup>73</sup> requires us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation. We have considered, and discuss below, the effects of the proposed amendment to Securities Act Rule 146, with regard to BATS' proposed listing standards to designate certain securities that would be listed on BATS as Covered

Securities, on efficiency, competition, and capital formation, as well as the benefits and costs associated with the proposed rulemaking.

Congress amended Section 18 of the Securities Act to exempt covered securities from state registration requirements. These securities are listed on the Named Markets or any other national securities exchange determined by the Commission to have "substantially similar" listing standards to those of the Named Markets ("Designated Markets").<sup>74</sup> The Commission proposes to determine (if the Commission were to approve the proposed listing standards filed by BATS) that the listing standards for securities listed on BATS are substantially similar to those of a Named Market, specifically Nasdaq/NGM or NYSE Amex. Securities listed, or authorized for listing, on BATS therefore would be exempt from state law registration requirements.

There are three Named Markets (NYSE, NYSE Amex, and Nasdaq/NGM) and currently five Designated Markets (Tier I of NYSE Arca, Tier I of the Philadelphia Stock Exchange, CBOE, ISE, and Nasdaq/NCM). NYSE and Nasdaq/NGM are currently the largest exchanges in terms of number of securities listed. As of April 19, 2011, in terms of securities listed, NYSE lists 3,255, Nasdaq/NGM lists 2,854, NYSE Arca lists 1,213, and NYSE Amex lists 544.<sup>75</sup>

The direct economic effect of the proposed rule would be to exempt issuers that list, or are authorized to list, on BATS from the requirements of state registration. Instead, these issuers would be required to comply with BATS' proposed listing standards and the federal securities laws, rules and regulations with respect to the registration and sale of securities. The requirements of state registration typically include: (i) Paperwork and labor hours necessary to comply with state registration requirements, (ii) meeting the disclosure standards, and (iii) in some states, meeting certain minimum merit requirements to make public offerings.<sup>76</sup>

<sup>74</sup> See 15 U.S.C. 77r(b)(1)(B).

<sup>75</sup> These listed securities include exchange traded funds and multiple securities from the same issuer.

<sup>76</sup> A commentator noted that the purpose of such review is "to prevent 'unfair' and 'oppressive' offerings of securities," and, as of 2011, merit review is employed in about 30 states. See Jeffrey B. Bartell & A.A. Sommer, Jr., *Blue Sky Registration*, in *Securities Law Techniques* (Matthew Bender ed., 2011). Typical elements of merit review include: offering expenses, including underwriter's compensation, rights of security holders, historical ability to service debt or pay dividends, financial

combination of common stocks and warrants). See, e.g., Securities Exchange Act Release No. 48464 (September 9, 2003), 68 FR 54250 (September 16, 2003) (order approving NYSE Amex proposed rule change to amend Sections 101 and 1003 of the NYSE Amex Company Guide to clarify the listing requirements applicable to units).

<sup>67</sup> See generally proposed BATS Rule 14.4, Section 101(f) of the NYSE Amex Company Guide, and Nasdaq Rule 5225.

<sup>68</sup> See Securities Exchange Act Release No. 64546, *supra* note 8, 76 FR 31660 at 31664.

<sup>69</sup> Compare proposed BATS Rule 14.11 with Nasdaq Rule 5700 Series.

<sup>70</sup> See Securities Exchange Act Release No. 58673, *supra* note 1.

<sup>71</sup> See Securities Exchange Act Release No. 59575, *supra* note 1.

<sup>72</sup> See Securities Exchange Act Release Nos. 58179, 58183, and 62783, *supra* note 11.

<sup>73</sup> 15 U.S.C. 77b(b).



An indirect effect of the proposed rule would be that, by removing the requirements of state registration for issuers that list, or are authorized to list, on BATS—the same privilege granted to other Covered Securities—the rule could improve BATS' ability to compete effectively with other exchanges. Therefore, an important economic effect of the rule could be to engender greater competition in the market for listing services.

Exchanges generally compete in multiple areas, which include the market for listing, the market for trading, and the market for order-flow. This proposed rule and BATS' proposed listing standards<sup>77</sup> relate primarily to the market for listing, although the proposed rule (should it be adopted) and the entry of a new participant in the listings market could impact other markets as well.<sup>78</sup> In the market for listing, exchanges compete for issuers to list on their exchanges, so that the exchange may collect listing fees. Domestic exchanges face listing competition from other domestic exchanges and from foreign exchanges.<sup>79</sup> The benefit of listing for issuers generally is to gain greater access to capital through measures designed to help promote quality certification and visibility to public investors, which will generally result in a reduction in the cost of raising capital for these issuers. This access to capital may be further enhanced through listing on particular

condition of the issuer, cheap stock held by insiders, the quantity of securities subject to options and warrants, self-dealing and other conflicts of interest, and the price at which the securities will be offered. *See id.* Some merit regulation would be imposed on these issuers through application of exchange listing standards.

<sup>77</sup> See Securities Exchange Act Release No. 64546, *supra* note 8.

<sup>78</sup> *See, e.g.,* Thierry Foucault and Christine A. Parlour, *Competition for Listing*, 35 *Rand J. Econ.* 329 (2004) (describing how listing fees and trading costs both affect firms' incentives to list with one exchange versus another).

<sup>79</sup> It has been noted that NYSE and the London Stock Exchange, for example, compete for listings of firms in third countries, in particular from emerging economies. *See* Thomas J. Chemmanur & Paolo Fulghieri, *Competition and Cooperation Among Exchanges: A Theory of Cross-Listing and Endogenous Listing Standards*, 82 *J. Fin. Econ.* 455, 456 (2006). *See generally* Craig Doidge, Andrew Karolyi, and René Stulz, *Has New York Become Less Competitive than London in Global Markets? Evaluating Foreign Listing Choices Over Time*, *Journal of Financial Economics* 91, 253–277 (2009); Craig Doidge, Andrew Karolyi, and René Stulz, *Why Do Foreign Firms Leave U.S. Equity Markets?*, *Journal of Finance* 65, 1507–1553 (2010); Caglio, Cecilia, Hanley, Kathleen Weiss and Marietta-Westberg, Jennifer, *Going Public Abroad: The Role of International Markets for IPOs* (March 16, 2010), available at SSRN: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1572949](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1572949). Additionally, differences in regulatory regimes may impact listing decisions.

exchanges, which could affect the level of investors' trust in a listed company's governance structure and the fairness of trading in the company's securities (through the perceived effectiveness of exchanges' conduct rules and surveillance of trading as well as other services and regulatory functions).

Exchanges may try to compete for issuers by reducing listing fees or by improving the quality of services they offer, or both. The cost of listing for an issuer includes listing fees and the cost of complying with listing standards. In principle, this means exchanges can compete by reducing listing fees, by relaxing the listing standards issuers must meet, or by offering several trading segments with different listing standards on each, though such standards must be determined to be substantially similar to a Named Market in order to get the benefit of the Securities Act Section 18(b)(1)(B) exemption from state registration requirements. Any concern that exchanges may try to compete by lowering the listing standards to attract issuers (and hence enter in a "race-to-the-bottom") is mitigated by the fact that (1) Listing standards affect exchanges' reputations among investors, which, in turn, impacts their attractiveness to issuers, (2) any proposed listing standards or proposed changes to existing listing standards must be filed with the Commission pursuant to Section 19(b) of the Securities Exchange Act of 1934, as amended ("Exchange Act") and must meet its requirements to become effective,<sup>80</sup> and (3) lower listing standards that are not substantially similar to those of a Named Market will not have the benefit of the exemption from state registration requirements.<sup>81</sup>

The competition among exchanges for listings is only partially based on price. Exchanges also compete in various other areas, which contribute to the quality of the service listed issuers receive, including, but not limited to, provision of trade statistics, regulatory and surveillance services, access to new technology, attractive trading mechanisms, and marketing services.

One important dimension of competition is brand name.<sup>82</sup> Issuers

place high value on being listed on certain exchanges because investors may more readily trust those exchanges, which may, in turn, reduce the cost of raising capital for those issuers. As a result, NYSE and Nasdaq/NGM, which are already the two largest exchanges in terms of securities listed, may be able to charge listing fees that are above marginal cost—that is, what it would cost them to list additional issuers—and higher than other competing exchanges; therefore, certain exchanges may earn economic rent from these higher listing premiums (the amount of fee difference certain exchanges can charge, above a competitor's price, because of its brand name). In addition to brand name recognition, the market for listing exhibits positive network externalities: issuers may prefer to be listed on exchanges where many other issuers are listed and where there are more intermediaries trading because of increased liquidity and visibility.<sup>83</sup> This indicates that, all else being equal, large exchanges (in terms of listings) will tend to be favored over smaller ones. In theory, this preference may persist to some extent even if large exchanges were to offer slightly inferior services than their smaller counterparts because the advantages of being listed on a large exchange, where there are many issuers and intermediaries, might outweigh the cost of being offered slightly inferior services. Because of these brand name effects and positive externalities, the market for listings to some extent exhibits certain barriers to entry for new entrants to the listing markets, such as BATS.<sup>84</sup>

of brand name on competition in markets with incomplete information); *see also* Tibor Scitovsky, *Ignorance as a Source of Oligopoly Power*, 40 *Amer. Econ. Rev.* 48, 49 (1950) ("An ignorant buyer \* \* \* is unable to judge the quality of the products he buys by their intrinsic merit. Unable to appraise products by objective standards, he is forced to base his judgment on indices of quality, such as \* \* \* general reputation of the producing firms.").

<sup>83</sup> *See, e.g.,* Carmine Di Nola, *Competition and Integration Among Stock Exchanges in Europe: Network Effects, Implicit Mergers and Remote Access*, 7 *European Fin. Man.* 39 (2001) ("Firms may derive more utility in being listed on exchanges where there are more intermediaries as they give more liquidity to the market.").

<sup>84</sup> Brand name recognition is frequently recognized as a barrier to entry mainly because consumers do not have all the information regarding product quality and thus tend to rely on brand names as a proxy for quality. *See, e.g.,* *Brand Name as a Barrier to Entry: The Rea Lemon Case*, 51 *S. Econ. J.* 495 (1984); Tibor Scitovsky, *Ignorance as a Source of Oligopoly Power*, 40 *Amer. Econ. Rev.* 48 (1950). Network externalities are also recognized as a barrier to entry. *See, e.g.,* Gregory J. Weden, *Network Effects and Conditions of Entry: Lessons from the Microsoft Case*, 69 *Antitrust L.J.* 87 (2001); Douglas A. Melamed, *Network Industries and Antitrust*, 23 *Harv. J. L. & Pub. Pol'y* 147 (1999).

<sup>80</sup> Any revision to exchange listing standards must be done in accordance with Section 19(b) of the Exchange Act and Rule 19b-4 thereunder. Any Commission approval of a listing standard revision is conditioned upon a finding by the Commission that the revision is consistent with the requirements of the Exchange Act and rules thereunder. *See* 15 U.S.C. 78s.

<sup>81</sup> *See* Chemmanur & Fulghieri, *supra* note 79, at 458.

<sup>82</sup> *See generally* Clement G. Krouse, *Brand Name as a Barrier to Entry: The Rea Lemon Case*, 51 *Southern Econ. J.* 495 (1984) (describing the effect

### *B. Benefits, Including the Impact on Efficiency, Competition, and Capital Formation*

By proposing to exempt securities listed, or authorized for listing, on BATS from state law registration requirements, the Commission expects that issuers seeking to list securities on BATS could have the benefit of reduced regulatory compliance burdens, as compliance with state blue sky law requirements would not be required. One benefit of this proposal would be to eliminate these compliance burdens with respect to securities listed, or authorized for listing, on BATS. The Commission expects that the proposed rule could also improve efficiency by eliminating duplicative registration costs for issuers and improving liquidity by allowing for greater market access to issuers who have not been listed previously.

To the extent that state merit reviews may have inhibited certain smaller businesses from making public offerings,<sup>85</sup> an exemption from state registration requirements could facilitate capital formation.

The Commission preliminarily believes that the proposed amendment to Rule 146(b) should permit BATS to better compete for listings with other markets whose listed securities already are exempt from state law registration requirements. This result could enhance competition, thus benefiting market participants and the public.

Specifically, BATS currently intends to enter the listing market with generally lower fees than incumbent exchanges in order to compete with

them.<sup>86</sup> In response to BATS' proposed entry, although recognizing the significant barriers to entry noted above, the incumbent exchanges might choose to reduce their listing fees to match or come closer to those proposed by BATS. Incumbent exchanges might also enhance the other services they provide to their currently listed issuers (*e.g.*, regulatory and surveillance services, access to new technology, attractive trading mechanisms, marketing services) as a way to counteract BATS' proposed lower listing fees.

Additional competition in the market for listings could enable some issuers, both public and private, that have (1) either not listed on any exchange or (2) have listed on an exchange but have chosen not to list on certain exchanges because of the costs of listing there, to list on any Named or Designated Market due to the potential for lower listing fees across all exchanges. This potentially could result in a lower cost of capital for those issuers that previously had not listed on an exchange and could benefit the current investors in such issuers in the form of higher company value arising from the reduced cost of capital and increased liquidity. If currently unlisted firms were able to list because of lower listing fees, this could also improve efficiency and capital formation since future investors in these issuers would have easier access to invest in them and to further diversify their investment portfolios.

Those issuers that are currently listed on any exchange, including the Named Markets, and that remain listed there, would potentially benefit from any reduced listing fees; however, because any such benefit would come at the expense of the exchange on which they are listed in the form of potentially reduced profit, this aggregate effect would be a transfer from one group of investors (exchange shareholders) to another group of investors (listed issuer shareholders).

Additionally, some issuers currently listed on other Named or Designated Markets could potentially switch their listings to BATS, thus potentially lowering their listing costs (provided the Named or Designated Markets did not reduce their listing fees). The size of any such potential benefit would depend on how large any cost savings due to listing on BATS would be in comparison to the cost of giving up any

valuable services that the other exchanges might provide that BATS might not. In addition, the behavior of these issuers would depend heavily on the extent to which these other exchanges respond to BATS' proposed entry by making themselves more competitive to the issuers.

### *C. Costs, Including the Impact on Efficiency, Competition, and Capital Formation*

The proposed amendment would eliminate state registration requirements for securities listed, or authorized for listing, on BATS. In principle, there could be certain economic costs to investors through the loss of benefits of state registration and oversight. For example, by listing on BATS, issuers would no longer be required to comply with certain states' blue sky laws, which could mandate more detailed disclosure than BATS' proposed listing standards and the requirements imposed pursuant to the federal securities laws, rules, and regulations. In such circumstances, investors could lose the benefit of the additional information. Additionally, to the extent blue sky laws result in additional enforcement protections in the form of another regulator policing issuer activity, then investors from these states could incur costs when issuers choose to list on BATS. Some commentators have also expressed a concern that the exemption from blue sky laws could prompt riskier public offerings.<sup>87</sup>

From the perspective of competition in the market for listing, the Commission notes that there could be a concern that, to the extent the market for exchange services exhibits network effects, as explained above, there could be a loss in efficiency as a result of having a greater number of networks, if one or more of the existing large exchanges (in terms of listings) shrinks in size. However, the Commission also notes that the overall efficiency effect would depend on the precise fragmentation of the exchanges. It is possible, for instance, that, through specialization of exchanges, there could be an efficiency gain from having more distinct exchanges, each of which specializes in listing issuers from certain types of industries.

The Commission acknowledges that these costs are difficult to quantify. The Commission believes that Congress contemplated these costs in relation to the economic benefits of exempting Covered Securities from state regulation. The Commission, however, is considering the costs of the proposed

<sup>85</sup> A number of scholarly articles have expressed concerns over the possibility for blue sky merit regulation to hinder capital formation. *See, e.g.*, Martin Fojas, *Ay Dios NSMIA!: Proof of a Private Offering Exemption Should Not Be a Precondition for Preempting Blue Sky Law Under the National Securities Markets Improvement Act*, 74 Brooklyn L. Rev. 477 (2009); Rutheford B. Campbell, Jr., *Blue Sky Laws and the Recent Congressional Preemption Failure*, 22 J. Corp. L. 175 (1997); Brian J. Fahrney, *State Blue Sky Laws: A Stronger Case for Federal Pre-emption Due to Increasing Internationalization of Securities Markets*, Comment, 86 Nw. U. L. Rev. 753 (1991–92); Roberta S. Karmel, *Blue-Sky Merit Regulation: Benefit to Investors or Burden on Commerce*, 53 Brook. L. Rev. 106 (1987–88). While the concerns are numerous, other studies have shown some positive effect of merit regulation. *See* Jay T. Brandi, *The Silverlining in Blue Sky Laws: The Effect of Merit Regulation on Common Stock Returns and Market Efficiency*, 12 J. Corp. L. 713 (1986–87) (reporting that merit regulation can have a positive effect on investor returns); Ashwini K. Agrawal, "The Impact of Investor Protection Law on Corporate Policy: Evidence from the Blue Sky Laws," working paper (2009) (reporting that the passage of investor protection statutes causes firms to pay out greater dividends, issue more equity, and grow in size), available at <http://ssrn.com/abstract=1442224>. Some merit regulation would be imposed on these issuers through application of exchange listing standards.

<sup>86</sup> *See* Securities Exchange Act Release No. 64546, *supra* note 8, 76 FR at 31666 & n. 27–28 (representing that BATS' proposed pricing, while not necessarily cheaper for all issuers at all other markets, is roughly equivalent to or less than the price issuers would pay at other exchanges, including NGM and NCM).

<sup>87</sup> *See, e.g.*, Brandi, *supra* note 85.



amendment to Rule 146(b) and requests commenters to provide views and supporting information as to the costs and benefits associated with this proposal. The proposed rule otherwise imposes no recordkeeping or compliance burdens, but would provide a limited purpose exemption under the federal securities laws.

Overall, the Commission believes the proposed amendment to Rule 146(b) should not impair efficiency, competition, and capital formation.

#### *D. Request for Comment*

We request comment on the costs and benefits associated with this rule amendment, including identification and assessments of any costs and benefits not discussed in this analysis. We solicit comments on the usefulness of the rule amendment to investors, reporting persons, registrants, and the marketplace at large. We encourage commentators to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits, as well as any costs and benefits not already defined. We also request qualitative feedback on the nature of the benefits and costs described above. Additionally, we request comment on the extent of any costs that may be attributable to any loss of protections that currently are afforded by the state registration process, such as any merit-based requirements imposed by states on issuers.

#### **VII. Regulatory Flexibility Act Certification**

Section 603(a) of the Regulatory Flexibility Act<sup>88</sup> requires the Commission to undertake an initial regulatory flexibility analysis of the proposed amendment to Rule 146 on small entities, unless the Commission certifies that the proposed amendment, if adopted, would not have a significant economic impact on a substantial number of small entities.<sup>89</sup> For purposes of Commission rulemaking in connection with the Regulatory Flexibility Act, an issuer is a small business if its “total assets on the last day of its most recent fiscal year were \$5 million or less.”<sup>90</sup>

The Commission believes that the proposal to amend Rule 146(b) would not affect a substantial number of small entities because, as proposed by BATS, to list its securities on BATS, an issuer’s aggregate market value of publicly held shares would be required to be at least \$5 million. If an entity’s market value of

publicly held shares were at least \$5 million, it is reasonable to believe that its assets generally would be worth more than \$5 million. Therefore, an entity seeking to list securities as proposed by BATS in its proposed listing standards generally would have assets with a market value of more than \$5 million and thus would not be a small entity.

Accordingly, the Commission hereby certifies, pursuant to Section 605(b) of the Regulatory Flexibility Act,<sup>91</sup> that amending Rule 146(b) as proposed would not have a significant economic impact on a substantial number of small entities. The Commission encourages written comments regarding this certification. The Commission solicits comment as to whether the proposed amendment to Rule 146(b) could have an effect that has not been considered. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

#### **VIII. Small Business Regulatory Enforcement Fairness Act of 1996**

For purposes of the Small Business Enforcement Fairness Act of 1996, a rule is “major” if it results or is likely to result in:

- (i) An annual effect on the economy of \$100 million or more;
- (ii) A major increase in costs or prices for consumers or individual industries; or
- (iii) Significant adverse effects on competition, investment, or innovation.<sup>92</sup>

The Commission requests comment regarding the potential impact of the proposed amendment on the economy on an annual basis. Commenters should provide empirical data to support their views to the extent possible.

#### **IX. Statutory Authority and Text of the Proposed Rule**

The Commission is proposing an amendment to Rule 146 pursuant to the Securities Act of 1933,<sup>93</sup> particularly Sections 18(b)(1)(B) and 19(a).<sup>94</sup>

#### **List of Subjects in 17 CFR Part 230**

Securities.

For the reasons set forth in the preamble, the Commission proposes to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

#### **PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933**

1. The authority citation for Part 230 continues to read, in part, as follows:

**Authority:** 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z–3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a–8, 80a–24, 80a–28, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

\* \* \* \* \*

2. Revise Section 230.146(b)(1) and (b)(2) to read as follows:

#### **§ 230.146 Rules under section 18 of the Act.**

\* \* \* \* \*

(b) \* \* \*

(1) For purposes of Section 18(b) of the Act (15 U.S.C. 77r), the Commission finds that the following national securities exchanges, or segments or tiers thereof, have listing standards that are substantially similar to those of the New York Stock Exchange (“NYSE”), the NYSE Amex LLC (“NYSE Amex”), or the National Market System of the Nasdaq Stock Market (“Nasdaq/NGM”), and that securities listed, or authorized for listing, on such exchanges shall be deemed covered securities:

- (i) Tier I of the NYSE Arca, Inc.;
- (ii) Tier I of the NASDAQ OMX PHLX LLC;
- (iii) The Chicago Board Options Exchange, Incorporated;
- (iv) Options listed on the International Securities Exchange, LLC;
- (v) The Nasdaq Capital Market; and
- (vi) BATS Exchange, Inc.

(2) The designation of securities in paragraphs (b)(1)(i) through (vi) of this section as covered securities is conditioned on such exchanges’ listing standards (or segments or tiers thereof) continuing to be substantially similar to those of the NYSE, NYSE Amex, or Nasdaq/NGM.

\* \* \* \* \*

By the Commission.

Dated: August 8, 2011.

**Elizabeth M. Murphy,**

*Secretary.*

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<sup>88</sup> 5 U.S.C. 603(a).

<sup>89</sup> 5 U.S.C. 605(b).

<sup>90</sup> 17 CFR 230.157. *See also* 17 CFR 240.0–10(a).

<sup>91</sup> 5 U.S.C. 605(b).

<sup>92</sup> Public Law 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C., and as a note to 5 U.S.C. 601).

<sup>93</sup> 15 U.S.C. 77a *et seq.*

<sup>94</sup> 15 U.S.C. 77r(b)(1)(B) and 77s(a).