

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-70964; File No. SR-BATS-2013-060)

December 2, 2013

Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Modify the Risk Monitoring Functionality Offered by the Exchange

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 18, 2013, BATS Exchange, Inc. (the “Exchange” or “BATS”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange has designated this proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6)(iii) thereunder,<sup>4</sup> which renders it effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange filed a proposal to amend Rule 21.16, entitled “Risk Monitor Mechanism”, in order to modify the risk monitoring functionality offered to all Users<sup>5</sup> of the BATS equity options trading platform (“BATS Options”) and to make a clarifying change to the rule text.

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

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

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

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

<sup>5</sup> As defined in Exchange Rule 16.1(a)(63), a User is any Exchange member or sponsored participant authorized to obtain access to the Exchange.

The text of the proposed rule change is available at the Exchange's web site at <http://www.batstrading.com>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

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

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

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

1. Purpose

The purpose of the proposed rule changes are: (1) to amend Exchange Rule 21.16(b)(ii) in order add a new percentage-based Specified Engagement Trigger<sup>6</sup> to the Risk Monitor Mechanism; (2) to amend BATS Rule 21.16(c) in order to provide more granular cancellation of orders under the Risk Monitor Mechanism; (3) to make a clarifying change to BATS Rule 22.11; and (4) to add BATS Rule 21.16(e). Specifically, the Exchange proposes to amend Rule 21.16(b)(ii), entitled "Specified Engagement Triggers", in order to adopt a new type of Specified Engagement Trigger that will be triggered whenever a trade counter has calculated that the User has traded a certain percentage within a time period specified by the Exchange against the User's orders in a specified class. The Exchange also proposes to amend Rule 21.16(c) such that an incoming order that is received prior to the time that the Risk Monitor Mechanism is engaged

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<sup>6</sup> As defined in Exchange Rule 21.16(b)(ii).

and is executable against a User's quotation will execute up to the entire size of the User's quotation that would cause executions in excess of the User's Specified Engagement Trigger, but any additional executable quotations will be cancelled. The Exchange further proposes to amend Rule 22.11 in order to clarify the functionality of mass cancellation of trading interest, and to add Rule 21.16(e) in order to make clear that a User may engage the Risk Monitor Mechanism in order to implement such mass cancellation functionality.

### **Overview**

Currently, the Exchange's Risk Monitor Mechanism operates by the System maintaining a counting program for each User. A single User may configure a single counting program or multiple counting programs to govern its trading activity (i.e., on a port by port basis). The counting program will count executions of contracts traded by each User and in specific Option Categories (as defined below) by each User. The counting program counts executions, contract volume, and notional value, within a specified time period established by each User (the "specified time period") and on an absolute basis for the trading day ("absolute limits"). The specified time period commences for an option when a transaction occurs in any series in such option. The counting program also counts a User's executions, contract volume, and notional value across all options which a User trades. The counting program counts executions in the following "Options Categories": front-month puts, front-month calls, back-month puts, and back month calls (each an "Option Category"). The counting program also counts a User's executions, contract volume, and notional value across all options which a User trades ("Firm Category"). For the purposes of the Risk Monitor Mechanism, a front-month put or call is an option that expires within the next two calendar months, including weeklies and other non-

standard expirations, and a back-month put or call is an option that expires in any month more than two calendar months away from the current month.

The System engages the Risk Monitor Mechanism in a particular option when the counting program has determined that a User's trading has reached a Specified Engagement Trigger established by such User during the specified time period or on an absolute basis. When a Specified Engagement Trigger is reached in an Options Category, the Risk Monitor Mechanism will automatically remove such User's orders in all series of the particular option and reject any additional orders from a User in such option until the counting program has been reset in accordance with paragraph (d) of Rule 21.16. The Risk Monitor Mechanism also attempts to cancel any orders that have been routed away to other options exchanges on behalf of the User.

As provided in subparagraph (b)(ii) of BATS Rule 21.16, each User can, optionally, establish Specified Engagement Triggers in each Options Category, per option, or in the Firm Category. Specified Engagement Triggers can be set as follows: (A) a contract volume trigger, measured against the number of contracts executed (the "volume trigger"); (B) a notional value trigger, measured against the notional value of executions<sup>7</sup> (the "notional trigger"); and (C) an execution count trigger, measured against the number of executions ("count trigger"). Each of these triggers can be established in isolation (e.g., a User may choose only to implement a volume trigger) or a User can establish multiple separate triggers with different parameters. Also, as described above, the triggers can be implemented either as absolute limits or over a specified period of time.

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<sup>7</sup> Notional value is calculated as the sum of all premiums paid times the number of contracts executed. For example, an option executed with a premium of \$3.00 for 5 contracts would count as \$15.00 notional value.

Rule 22.11, entitled “Mass Cancellation of Trading Interest” currently provides that a User may simultaneously cancel all its bids, offers, and orders in all series of options by requesting the Exchange staff to effect such cancellation. The form of such requests includes but is not limited to email or phone call from authorized individuals, and the Risk Monitor Mechanism. As part of Rule 22.11, a User may submit a request to cancel a subset or the entirety of its outstanding orders.

**Percentage-Based Engagement Trigger**

The Exchange proposes to create a new Specified Engagement Trigger to the Risk Monitor Mechanism based on percentage under BATS Rule 21.16(b)(ii) (the “percentage trigger”). The proposed percentage trigger would be triggered whenever a trade counter has calculated that the User has traded a set percentage (designated by the User) within a set time period (designated by the Exchange) against the User’s orders in a specified class. The set percentage is specified by the User (the “Specified Percentage”) and will be calculated as follows (and as shown in the examples below): (1) a counting program would first calculate, for each series of an option class, the percentage of a User’s combined order and quote size that is executed on each side of the market, including both displayed and non-displayed size; and (2) a counting program would then sum the overall series percentages for the entire option class to calculate the percentage.

**Example 1**

For Examples 1 and 2, if a User enters orders at the National Best Bid or Offer (“NBBO”) in four series of a class and its Specified Percentage is 100%, a counting program would calculate such percentage as follows:

Series	Quote Size	# of Contracts Executed	Series Percentage
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Series 1	100	40	40%
Series 2	50	20	40%
Series 3	200	20	10%
Series 4	150	15	10%
<b>Total</b>	<b>500</b>	<b>95</b>	<b>100%</b>

In Example 1, the aggregate number of contracts executed among all series during the time period specified by the Exchange that equals the specified percentage of 100% is 95 contracts, at which point the percentage trigger would be triggered and the User’s remaining orders in the appointed class would be cancelled.

**Example 2**

<b>Series</b>	<b>Quote Size</b>	<b># of Contracts Executed</b>	<b>Series Percentage</b>
Series 1	100	0	0%
Series 2	50	0	0%
Series 3	200	0	0%
Series 4	150	150	100%
<b>Total</b>	<b>500</b>	<b>150</b>	<b>100%</b>

In Example 2, the aggregate number of contracts executed among all series during the time period specified by the Exchange that equals the specified percentage of 100% is 150 contracts, at which point the percentage trigger would be triggered and the User’s remaining quotes in the appointed class would be cancelled.

**Example 3**

For Example 3, if a User is quoting at the NBBO in four series of a particular option class, and specifies its percentage trigger at 200%, a trade counter would calculate such percentage as follows:

<b>Series</b>	<b>Quote Size</b>	<b># of Contracts Executed</b>	<b>Series Percentage</b>
Series 1	100	80	80%
Series 2	50	40	80%
Series 3	200	40	20%
Series 4	150	30	20%
<b>Total</b>	<b>500</b>	<b>190</b>	<b>200%</b>

In Example 3, the aggregate number of contracts executed among all series during the time period specified by the Exchange that equals the specified percentage of 200% is 190 contracts, at which point the percentage trigger would be triggered and the User's remaining quotes in the appointed class would be cancelled.

### **Order Cancellation**

The Exchange also proposes to amend Rule 21.16(c) regarding what will happen to marketable orders that are executable against a User's quotation that are received prior to the time that the Risk Monitor Mechanism is engaged. Specifically, the Exchange is proposing to amend the rule such that where there are marketable orders that are executable against a User's order or quotation that are received prior to the time that the Risk Monitor Mechanism is engaged will be automatically executed up to the size of the User's quotation (but not *all* of the User's quotations, as currently implemented). For example, where a single User's Specified Engagement Trigger is 150 contracts, the User has entered the following sell orders in a given

series that are resting at the Exchange, and the next most aggressively priced sell order in the series is 10.04:

<i>Price Level</i>	<i>Quoted Size</i>
10.01	100
10.02	100
10.03	150

Where another User then enters a 300 contract buy order priced at 10.03, the Exchange will allow the orders priced at 10.01 and 10.02 to execute in full, even though the execution of the 10.02 order will result in an execution of a total of 200 contracts, which will exceed the Specified Engagement Trigger of 150 contracts. The Exchange will then cancel the entirety of the 10.03 order and the remaining portion of the buy order will behave as indicated by the other User indicated upon entry. Under the current implementation, the Exchange would allow the entirety of the buy order to execute before cancelling any of the User's orders, meaning that the orders priced at 10.01 and 10.02 would execute in full and 100 shares of the order priced at 10.03 would execute, at which point the remaining 50 shares of the order priced at 10.03 would be cancelled. The Exchange believes that this change in the implementation of the Risk Monitor Mechanism will provide an appropriate level of additional protection for firms using the mechanism such that, while their risk limits can be exceeded to satisfy an incoming order, such limits will be better protected by cancelling interest after the first quotation has been executed that equals or exceeds the User's Specified Engagement Trigger (i.e., the Exchange will not allow an incoming order to execute against all of a User's quotations even after their risk limits have been breached).

**Clarifying Changes**



The Exchange also proposes to make a clarifying amendment to Rule 22.11 in order to make the mass cancellation functionality more clear. As described above, a User may submit a request to cancel any subset or the entirety of its outstanding orders. The Exchange is proposing to clarify Rule 22.11 in order to make clear that a User may request to cancel orders for a specified underlying security.

Similarly, the Exchange proposes to make a clarifying change by adding paragraph 21.16(e) in order to make clear that a User may engage the Risk Monitor Mechanism in order to use the mass cancellation functionality from Rule 22.11.

## 2. Statutory Basis

The rule change proposed in this submission is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.<sup>8</sup> Specifically, the proposed change is consistent with Section 6(b)(5) of the Act,<sup>9</sup> because it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to, and perfect the mechanism of, a free and open market and a national market system. The Exchange believes that the proposal is appropriate and reasonable because it offers additional functionality for Users to manage their risk. Offering the percentage trigger and more granular order cancellation as part of the Risk Monitor Mechanism will provide Market Makers and other Users with greater control and flexibility with respect to managing risk and the manner in which they enter orders and quotes, allowing them to quote more aggressively, which

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

<sup>9</sup> 15 U.S.C. 78f(b)(5).

removes impediments to a free and open market and benefits all Users of BATS Options. The Exchange notes that a similar functionality is offered by NYSE Arca, Inc. (“NYSE Arca Options”) and NYSE Amex Options, Inc. (“NYSE Amex Options”).<sup>10</sup>

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the act. To the contrary, the current variances between the Exchange’s Risk Monitor Mechanism and the risk monitoring available at other exchanges limit competition in that other exchanges are able to employ their risk management tools using a percentage-based trigger, while the Exchange cannot employ such a trigger. Thus, approval of the proposed rule change will promote competition because it will allow the Exchange to offer its Users similar percentage triggers as are available at other exchanges and thus compete with other exchanges for order flow that a User may not have directed to the Exchange if the percentage trigger was not available.

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

The Exchange has neither solicited nor received written comments on the proposed rule change.

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

Because the foregoing proposed rule change does not: (1) significantly affect the protection of investors or the public interest; (2) impose any significant burden on competition; and (3) become operative for 30 days from the date on which it was filed, or such shorter time as

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<sup>10</sup> See NYSE Arca Options Rule 6.40(d); see also NYSE Amex Options Rule 928NY(d).

the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>11</sup> and Rule 19b-4(f)(6)(iii) thereunder.<sup>12</sup>

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

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-BATS-2013-060 on the subject line.

##### 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 No. SR-BATS-2013-060. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

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<sup>11</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>12</sup> 17 CFR 240.19b-4(f)(6).

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/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule changes 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 Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-BATS-2013-060 and should be submitted on or before [21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>13</sup> 17 CFR 200.30-3(a)(12).