

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71498; File No. SR-BATS-2013-066)

February 6, 2014

Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing of Amendment No. 1, and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Adopt Rules to Hold a Volatility Closing Auction

I. Introduction

On December 19, 2013, BATS Exchange, Inc. (the “Exchange” or “BATS”) filed with the Securities and Exchange Commission (“Commission”) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend Exchange Rule 11.23 to add a new auction type known as the Volatility Closing Auction. The proposed rule change was published for comment in the Federal Register on December 27, 2013.³ The Commission received one comment on the proposal.⁴ On January 14, 2014, BATS filed Amendment No. 1 to the proposed rule change.⁵ This order approves the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 71162 (December 20, 2013), 78 FR 79030 (“Notice”).

⁴ See Letter to Elizabeth M. Murphy, Secretary, Commission, from Abraham Kohen, AK FE Consultants LLC, dated December 23, 2013 (“Kohen Letter”). The commenter questioned the Exchange’s determination to refer to the new auction type as the Volatility Closing Auction and suggested that a more specific website address should be used within the Notice to direct readers to the text of the proposed rule change. The Exchange did not respond to the comment.

⁵ In Amendment No. 1, BATS amended the proposal to make clear that where a halt occurs before 3:50 p.m. E.T. and the Quote-Only Period for the associated Halt Auction would be extended between 3:50 p.m. and 4:00 p.m. E.T. such Halt Auction will, instead of being extended, immediately become a Volatility Closing Auction. The Amendment also proposes to amend the definition of “Quote-Only Period” as defined in Exchange Rule 11.23(a)(17) to include Volatility Closing Auctions.

II. Description of the Proposal

In its filing with the Commission, the Exchange proposes to add a new auction type to its rules, a Volatility Closing Auction, which will apply any time that an Exchange-listed security is halted during the last 10 minutes of Regular Trading Hours⁶ or where the Quote-Only Period⁷ of a Halt Auction would be extended during the last 10 minutes of Regular Trading Hours. In particular, the Exchange proposes to add the Volatility Closing Auction in preparation for the operation during the last 15 minutes of Regular Trading Hours of the National Market System Plan to Address Extraordinary Market Volatility (the “Limit Up-Limit Down Plan” or “Plan”).⁸

The Plan is designed to prevent trades in individual NMS Stocks from occurring outside of specified Price Bands.⁹ The requirements of the Plan are coupled with Trading Pauses, or halts, to accommodate more fundamental price moves (as opposed to erroneous trades or momentary gaps in liquidity). The Commission approved the Plan, as amended, on a one-year pilot basis.¹⁰ The Plan first became operational in April of 2013, with a staged rollout with respect to the portion of the trading day to which the Plan applies as well as the securities subject to the Plan. All trading centers in NMS Stocks, including both those operated by Participants and those operated by members of Participants, are required to establish, maintain, and enforce

⁶ Regular Trading Hours are defined in Exchange Rule 1.5(w) as the time between 9:30 a.m. to 4:00 p.m. E.T.

⁷ Quote-Only Period means a designated period of time prior to a Halt Auction or an IPO Auction during which Users may submit orders to the Exchange for participation in the auction. See Exchange Rule 11.23(a)(17).

⁸ See Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (File No. 4-631) (Order Approving, on a Pilot Basis, the National Market System Plan To Address Extraordinary Market Volatility).

⁹ Unless otherwise specified, capitalized terms used herein are based on the defined terms of the Plan.

¹⁰ See supra note 8.

written policies and procedures that are reasonably designed to comply with the requirements specified in the Plan. The Exchange is a Participant in the Plan.

As currently implemented, the Limit Up-Limit Down Plan applies to securities between 9:30 a.m. and 3:45 p.m. E.T. each trading day. In the near future, the operation of the Plan will be extended to include the time between 3:45 p.m. and 4:00 p.m. E.T., which is the end of Regular Trading Hours on the Exchange and is when the Exchange typically conducts a Closing Auction for each of its listed securities. The Exchange proposes to adopt rules for a Volatility Closing Auction in connection with the extension of the Plan to the end of Regular Trading Hours.

The Exchange proposes to add new paragraph (e) to Rule 11.23 to govern the operation of Volatility Closing Auctions on the Exchange, which will be auctions of Exchange-listed securities that are halted in the last 10 minutes of Regular Trading Hours or where the Quote-Only Period of a Halt Auction would be extended during the last 10 minutes of Regular Trading Hours.¹¹ As noted by the Exchange, a Volatility Closing Auction would operate in certain respects like an Exchange Halt Auction as described in Exchange Rule 11.23(d) and in other respects like an Exchange Closing Auction as described in Exchange Rule 11.23(c).¹²

According to the Exchange, similar to a Halt Auction on the Exchange, a Volatility Closing Auction will have a period of time that orders are accepted for participation in such auction during which no trading is occurring on the Exchange (the “Quote-Only Period”).¹³ The Quote-Only Period with respect to a Volatility Closing Auction would commence at the time a

¹¹ See Notice, supra note 3 at 79031.

¹² See Id.

¹³ See Id.

security is halted between 3:50 p.m. and 4:00 p.m. and will end at 4:00 p.m.¹⁴ Thus, to the extent the Exchange halts a security after 3:55 p.m. but before 4:00 p.m., such security will be halted for less than five minutes prior to the Volatility Closing Auction.¹⁵ The Exchange believes this is appropriate because it will ensure that the final auction of the day in all Exchange-listed securities consistently occurs at 4:00 p.m. E.T.¹⁶

The Exchange notes it will not extend the Quote-Only Period associated with a Volatility Closing Auction, which is the same as with a Closing Auction.¹⁷ In contrast, the Exchange's rules related to Exchange Halt Auctions provide that the Quote-Only Period may be extended where there are unmatched market orders on the auction book associated with the auction and where the indicative price moves the greater of 10% or fifty (50) cents in the fifteen (15) seconds prior to the Halt Auction, both to ensure that there is sufficient interest and stability after a halt to reopen the security for trading.¹⁸ Halt Auctions, however, occur during Regular Trading Hours and the Exchange retains discretion to not extend the Quote-Only Period of a Halt Auction such that it would interfere with a Closing Auction. While the Exchange acknowledges that some of the same issues for which the ability to extend the Quote-Only Period of a Halt Auction may exist where there are unmatched market orders or dramatic price movements near the end of the Quote-Only Period of the Volatility Closing Auction, the Exchange believes that these concerns

¹⁴ See Proposed Rule 11.23(e).

¹⁵ See Notice, supra note 3 at 79031. The Exchange clarified that where a halt occurs before 3:50 p.m. E.T. and the Quote-Only Period for the associated Halt Auction would be extended between 3:50 p.m. and 4:00 p.m. E.T., such Halt Auction will, instead of being extended, immediately become a Volatility Closing Auction. See Amendment No. 1.

¹⁶ See Id.

¹⁷ See Id.

¹⁸ See Exchange Rule 11.23(d)(2)(B).

are outweighed by the importance of providing members and the investing public with a definitive market close and an official closing price at 4:00 p.m. E.T. The Exchange believes that the clarity that comes from requiring that a Volatility Closing Auction occurs at 4:00 p.m. E.T. will help reduce uncertainty for members participating in the Volatility Closing Auction.¹⁹

The Exchange highlights certain elements of its closing process that promote a fair and orderly closing, despite its determination to have Volatility Closing Auctions conclude at 4:00 pm. E.T. First, the Exchange notes that, even where a halt is declared very near 4:00 p.m. E.T., it has proposed that all Volatility Closing Auctions be required to close at a price level within the Collar Price Range²⁰ in order to ensure that the Volatility Closing Auction price is based on rational and current market conditions.²¹ Second, the Exchange further restricts the price of a Volatility Closing Auction by using the Final Last Sale Eligible Trade as the Volatility Closing Auction price where no limit orders from one or both sides would participate in the Volatility Closing Auction.²² According to the Exchange, this restriction ensures that there is crossed limit interest in the Volatility Closing Auction if the Volatility Closing Auction price is going to look to the entered limit interest to determine the price, which prevents a single limit order from interacting with market orders to determine the Volatility Closing Auction Price.²³ Finally, the Exchange notes that it retains discretion under Rule 11.23(f) (re-numbered pursuant to this proposal) to adjust the timing of or suspend an auction with prior notice to Users where the

¹⁹ See Notice, supra note 3 at 79031-2.

²⁰ See Exchange Rule 11.23(a)(6).

²¹ See Notice, supra note 3 at 79032.

²² See Proposed Rule 11.23(e)(2)(B).

²³ See Notice, supra note 3 at 79032.

interests of a fair and orderly market so require.²⁴ As noted by the Exchange, in a situation where the Exchange deemed it necessary to adjust the timing of a Volatility Closing Auction in order to maintain a fair and orderly market, i.e., to a time later than 4:00 p.m. E.T., the Exchange would notify Exchange Users in advance of the time that the auction would occur and would provide for a Quote-Only period prior to such auction.²⁵

During the Quote-Only Period of a Volatility Closing Auction, the Exchange will accept all orders eligible to participate in both a Halt Auction and a Closing Auction in order to avoid participant confusion and to facilitate participation in the Volatility Closing Auction. This includes limit and market orders as well as any Eligible Auction Orders applicable to a Closing Auction on the Exchange. Thus, the Exchange will accept Regular Hours Only orders (“RHOs”), Limit-On-Close orders (“LOCs”), Late-Limit-On-Close orders (“LLOCs”) and Market-On-Close orders (“MOCs”) for participation in a Volatility Closing Auction, and the typical restrictions on such orders will apply. For instance, as with a Closing Auction, the Exchange will not accept any LOCs or MOCs after 3:55 p.m. E.T. Similarly, the Exchange will not accept any LLOCs before 3:55 p.m. E.T. The Exchange notes, however, that, while these restrictions remain in place, regular limit and market orders can be entered and cancelled without restriction at any time prior to execution. In contrast to a typical Closing Auction, however, because the Exchange is accepting Eligible Auction Orders only to facilitate participation in and avoid confusion during the Volatility Closing Auction and because a User could alternatively enter and cancel limit orders and market orders without restriction during the Quote-Only Period, Eligible Auction Orders associated with a Volatility Closing Auction may also be cancelled at

²⁴ See Proposed Rule 11.23(f).

²⁵ See Notice, supra note 3 at 79032.

any time prior to execution.²⁶ The Exchange believes that allowing participants to cancel orders specifically designated for a Closing Auction up to the time of the Volatility Closing Auction is appropriate because halts or extensions of a Quote-Only Period of a Halt Auction in the last 10 minutes of the trading day necessitating a Volatility Closing Auction may be indicative of price dislocation in a security and because such orders may have been entered well before such event occurred.²⁷

With respect to market data, the Exchange represents that it will disseminate the same information that it does for other auctions conducted on the Exchange.²⁸ Thus, coinciding with the beginning of the Quote-Only Period for a security and updated every five seconds thereafter, the Reference Price, Indicative Price, Auction Only Price, and the lesser of Reference Buy Shares and Reference Sell Shares associated with the Volatility Closing Auction will be disseminated by the Exchange via electronic means.

The Exchange represents that it will conduct a Volatility Closing Auction in a manner similar to a Halt Auction. Specifically, orders will be executed at the price that maximizes the number of shares executed in the auction.²⁹ For ETPs, orders will be executed at the price level within the Collar Price Range that maximizes the number of shares executed in the auction. In the event of a volume based tie at multiple price levels, the price level closest to the Final Last Sale Eligible Trade will be used for Volatility Closing Auctions. Where no limit orders from one or both sides (the buy side, the sell side, or both the buy and sell side) would participate in a Volatility Closing Auction, the Volatility Closing Auction will occur at the price of the Final

²⁶ In a Closing Auction, LOC and MOC orders cannot be cancelled in the five minutes leading up to the auction.

²⁷ See Notice, supra note 3 at 79033.

²⁸ Id. at 79031.

²⁹ See Proposed Rule 11.23(e)(2)(B).

Last Sale Eligible Trade. According to the Exchange, the only differences between the processing of a Halt Auction and a Volatility Closing Auction are that: (1) the Volatility Closing Auction price will be used as the official closing price for dissemination to the consolidated tape (the “BATS Official Closing Price”), and (2) a Volatility Closing Auction will not be delayed due to a market order imbalance or due to a significant change in the Indicative Price, which can extend the Quote-Only Period of a Halt Auction, as explained above.³⁰

The Exchange also proposes to process a Volatility Closing Auction in a manner consistent with auctions conducted by the Exchange, in that, as proposed, market orders, including MOCs, will have higher priority than other Volatility Closing Auction Eligible Orders.³¹ To the extent there is executable contra side interest, such market orders will be executed at the BATS Official Closing Price according to time priority. After the execution of all market orders, the remaining orders priced at or more aggressively than the BATS Official Closing Price will be executed on the basis of price/time priority.³²

The Exchange will transition to the After Hours Trading Session³³ following a Volatility Closing Auction in much the way that it does for a Closing Auction.³⁴ Thus, limit order shares that are not executed in the Volatility Closing Auction will remain on the Exchange’s order book during the After Hours Trading Session, subject to a User’s instructions and the fact that certain auction specific limit orders will be cancelled.³⁵ RHO, LOC, LLOC, MOC and market order

³⁰ See Notice, supra note 3 at 79032.

³¹ See Proposed Rule 11.23(e)(2)(C).

³² See Id.

³³ The After Hours Trading Session is defined in Exchange Rule 1.5(c) and currently means the time between 4:00 p.m. to 5:00 p.m. E.T.

³⁴ See Proposed Rule 11.23(e)(3).

³⁵ See Id.

shares that are not executed in the Volatility Closing Auction will be cancelled at the conclusion of the Volatility Closing Auction.³⁶ According to the Exchange, the only difference between this transition and a typical Closing Auction is that market orders are also cancelled, which differs only because such orders may enter the Volatility Closing Auction in the first place.³⁷ Other than MOCs, which are specifically designated for a Closing Auction, market orders cannot participate in Closing Auctions because they do not post to the Continuous Book,³⁸ and thus the Exchange does not address their transition to the After Hours Trading Session in its Closing Auction transition process.

In addition to the changes described above, in order to correct a typographical error in the original filing that proposed Rule 11.23, the Exchange proposes to re-number paragraphs (g), (h) and (i) as (f), (g) and (h), respectively. Finally, the Exchange proposes to add a reference to the new auction type, a Volatility Closing Auction, to current paragraph (h) (to be re-numbered as (g)).

III. Discussion and Commission Findings

After careful review of the proposal, as modified by Amendment No. 1, and the comment letter received³⁹ the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national

³⁶ See Id.

³⁷ See Notice, supra note 3 at 79032.

³⁸ Market orders received by the Exchange are executed or routed by the Exchange to other market centers but do not post to the Exchange's Continuous Book. See Rules 11.9(a)(2), 11.13(a)(1) and 11.13(a)(2). The Continuous Book is defined in Exchange Rule 11.23(a)(7) as all orders on the BATS Book that are not Eligible Auction Orders.

³⁹ See Kohen Letter. The Commission believes that the Exchange may refer to this new auction as the Volatility Closing Auction as it directly relates to the policies and procedures necessary to implement the Limit Up-Limit Down Plan. The Commission believes that the commenter's more general comments regarding the domain address where an Exchange's rules are posted are not germane to this proposed rule change.

securities exchange.⁴⁰ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁴¹ which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, remove impediments to, and perfect the mechanism of, a free and open market and a national market system, and, in general, protect investors and the public.

The Exchange notes that all aspects of the proposed Volatility Closing Auction are based upon existing processes built into both the Exchanges' Halt Auction and the Exchange's Closing Auction. Consistent with existing auctions, the Exchange will accept all orders eligible to participate in both a Halt Auction and a Closing Auction and market orders, including MOCs, will have higher priority than other Volatility Closing Auction Eligible Orders. Such market orders, including MOCs, will be executed at the BATS Official Closing Price according to time priority to the extent there is executable contra side interest, after which remaining orders priced at or more aggressively than the BATS Official Closing Price will be executed on the basis of price/time priority.⁴² Additionally, the Exchange will continue to disseminate the same market data information for Volatility Closing Auctions as it does with existing auctions.

Without the proposal, the Exchange notes that it could potentially have a Halt Auction within minutes of the Closing Auction, which could cause unnecessary confusion. The Exchanges believes that this proposal is consistent with the Act and that the operation of a Volatility Closing Auction for securities listed on the Exchange will assist in the price discovery process and help to ensure a fair and orderly market for securities listed on the Exchange that are

⁴⁰ In approving the proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁴¹ 15 U.S.C. 78f(b)(1).

halted at the end of the trading day. The Exchange believes this proposal will ensure that market participants have a single closing price at the end of the trading day.

The Exchange's proposed Volatility Closing Auctions differs from its Halt Auctions and Closing Auctions in certain ways that it believes are appropriate and consistent with the Act. As discussed above, the Exchange's Volatility Closing Auction differs from its Halt Auction in that the Quote-Only Period for the Volatility Closing Auction will not, as a general matter, be extended. While the Exchange acknowledges that some of the same issues for which the ability to extend the Quote-Only Period of a Halt Auction may exist where there are unmatched market orders or dramatic price movements near the end of the Quote-Only Period of the Volatility Closing Auction, the Exchange believes that these concerns are outweighed by the importance of providing members and the investing public with a definitive market close and an official closing price at 4:00 p.m. E.T. The Exchange believes the clarity that comes from requiring a Volatility Closing Auction to occur at 4:00 p.m. E.T. will help reduce uncertainty for Members participating in the Volatility Closing Auction.⁴³

Despite its determination to have Volatility Closing Auctions conclude at 4:00 pm E.T., the Exchange highlights certain elements of its closing process that it believes promote a fair and orderly market and closing prices that are based on rational and current market conditions. As explained above, the Exchange has proposed certain price and execution constraints for the Volatility Closing Auction to ensure that the auction occurs at a price that is based on rational and current market conditions.⁴⁴ Additionally, the Exchange reiterates that it retains discretion

⁴² See Proposed Rule 11.23(e)(2)(C).

⁴³ See Notice, supra note 3 at 79031-2.

⁴⁴ See supra notes 21-26, 30, and accompanying text.

under Rule 11.23(f) to adjust the timing of or suspend an auction with prior notice to Users where the interests of a fair and orderly market so require.

The proposed Volatility Closing Auction also differs from Closing Auctions. Specifically, orders specifically designated for the Closing Auction are not permitted to be canceled after a certain time for Closing Auctions. In contrast, the Exchange proposes to allow participants to cancel orders specifically designated for a Closing Auction up to the time of the Volatility Closing Auction. The Exchange states that this is appropriate because the halt of trading of a security or extension of the Quote-Only Period of a Halt Auction in the last 10 minutes of the trading day necessitating a Volatility Closing Auction may be indicative of price dislocation in a security and because such orders may have been entered well before such halt occurred.⁴⁵ The Exchange believes it is appropriate and in the best interests of investors and the public interest to allow orders to be cancelled in such an event.

For the various reasons noted above, the Commission finds that the proposed rule change as modified by Amendment No. 1 is consistent with the Act, including Section 6(b)(5) of the Act,⁴⁶ which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, remove impediments to, and perfect the mechanism of, a free and open market and a national market system, and, in general, protect investors and the public.

The Commission finds good cause to approve the filing, as modified by Amendment No. 1 to the proposed rule change, prior to the thirtieth day after the date of the publication of notice of the filing thereof in the Federal Register. The proposed revisions should further enhance the

⁴⁵ The Exchange notes that its existing Halt Auction process allows orders to be cancelled prior to such auction.

⁴⁶ 15 U.S.C. 78f(b)(1).

Exchange's policies and procedures with respect to the operation of the Limit Up-Limit Down Plan. Accelerated approval would allow the Exchange to update its rule text immediately, thus providing users with greater clarity and certainty with respect to the use of the new Volatility Closing Auction functionality offered by the Exchange in anticipation of the application of the Limit Up-Limit Down plan through the end of Regular Trading Hours. Accordingly, the Commission finds that good cause exists, consistent with Section 6(b)(5) of the Act, to approve the filing, as modified by Amendment No. 1, on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 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. Please include File Number SR-BATS-2013-066 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 Number SR-BATS-2013-066. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the

proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal offices 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 Number SR-BATS-2013-066, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴⁷ that the proposed rule change, SR-BATS-2013-066, as modified by amendment No. 1, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁸

Kevin M. O'Neill
Deputy Secretary

⁴⁷ 15 U.S.C. 78s(b)(2).

⁴⁸ 17 CFR 200.30-3(a)(12).