

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-65500; File No. SR-BATS-2011-041)

October 6, 2011

Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt a Definition of Professional and Require that All Professional Orders be Appropriately Marked.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on September 29, 2011, BATS Exchange, Inc. (the “Exchange” or “BATS”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III 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 for the BATS Options Market (“BATS Options”) to amend Rule 16.1 (Definitions) to adopt a definition of “Professional” on the Exchange and require that all Professional orders be appropriately marked by Exchange members.

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.

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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).

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 this proposal is to amend Rule 16.1 (Definitions) to adopt a definition of “Professional” on the Exchange and require that all Professional orders be appropriately marked.

This filing is similar to previous filings of NASDAQ OMX BX, Inc. in connection with the rules of the Boston Options Exchange Group, LLC (“BOX”), the Nasdaq Stock Market LLC on behalf of the NASDAQ Options Market (“NOM”), PHLX NASDAQ OMX, Inc. (“Phlx”), the International Securities Exchange, LLC (“ISE”), and Chicago Board Options Exchange, Incorporated, (“CBOE”), which dealt with establishing a new definition of “Professional” as a person or entity that places a certain high volume of orders in listed options per day on average during a calendar month in his or her own beneficial account.<sup>5</sup>

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<sup>5</sup> See Securities Exchange Act Release Nos. 65036 (August 4, 2011), 76 FR 49517 (August 10, 2011) (SR-BX-2011-049); 63028 (October 1, 2010), 75 FR 62443 (October 8, 2010) (SR-NASDAQ-2010-099); 61802 (March 30, 2010), 75 FR 17193 (April 5, 2010) (SR-Phlx-2010-05); 61198 (December 17, 2009), 74 FR 68880 (December 29, 2009) (SR-CBOE-2009-078); and 59287 (January 23, 2009), 74 FR 5694 (January 30, 2009) (SR-ISE-2006-26). A filing by NYSE Amex LLC (“NYSE Amex”) proposing a similar Professional designation was based on the Phlx, ISE, and CBOE proposals. See

## Background

A member of BATS Options is known as an Options Member.<sup>6</sup> This is a firm or organization that is registered with the Exchange pursuant to Chapter XVII of the Exchange's Rules for purposes of participating in options trading on BATS Options as an Options Order Entry Firm or Options Market Maker.<sup>7</sup> Options traded by Options Members (which may include trades on behalf of Public Customers)<sup>8</sup> on BATS Options, a wholly electronic exchange, are electronically executable and routable. The System<sup>9</sup> and rules provide for the ranking, display, and execution of all orders in price/time priority without regard to the status of the person or entity entering an order.<sup>10</sup> The Exchange notes that BATS Options has, similar to

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Securities Exchange Act Release No. 61818 (March 31, 2010), 75 FR 17457 (April 6, 2010) (SR-NYSEAmex-2010-18). The cited filings discuss, among other things, the need for a Professional designation to be applied by members of the respective exchanges because the systems of such exchanges differentiate for execution or processing purposes based on order origin. BATS Options, like NOM and BOX, does not differentiate among orders based on their origin.

<sup>6</sup> See Rule 16.1(a)(38). Some Options Members are also members of other options exchanges such as, for example, ISE, CBOE, Phlx, or NOM.

<sup>7</sup> An "Options Order Entry Firm" or "Order Entry Firm" or "OEF" is defined in Rule 16.1(a)(36) as: "those Options Members representing as agent Customer Orders on BATS Options and those non-Market Maker Members conducting proprietary trading." Options Market Maker or Market Maker is defined in Rule 16.1(a)(37) as: "an Options Member registered with the Exchange for the purpose of making markets in options contracts traded on the Exchange and that is vested with the rights and responsibilities specified in Chapter XXII of [the Exchange's] Rules."

<sup>8</sup> "Public Customer" is defined in Rule 16.1(a)(46) as: "a person that is not a broker or dealer in securities."

<sup>9</sup> "System" is defined in Rule 16.1(a)(58) as: "the automated trading system used by BATS Options for the trading of options contracts."

<sup>10</sup> See Securities Exchange Act Release No. 61419 (January 26, 2010), 75 FR 5157, 5159 (February 1, 2010) (SR-BATS-2009-031). See also Rule 22.8, which discusses the price/time execution algorithm for System orders and states, in relevant part, that the System will execute trading interest at the best price in the System before executing trading interest at the next best price, and that the System will execute displayed orders before non-displayed orders at the same price.

BOX and NOM and in contrast to certain other options markets, a “flat” system that does not differentiate for execution or processing purposes among orders on the basis of who or what entity enters an order on the Exchange.<sup>11</sup> The Exchange notes that no change to execution priority on BATS Options is being proposed as part of this rule change.

The Exchange routes orders to other options exchanges (“Away Exchanges”) through its affiliate, BATS Trading, Inc. (“BATS Trading”), and through non-affiliated third-party broker-dealers. The Exchange’s general routing procedures are set forth in Rule 21.9 (Order Routing), which states in paragraph (c) that, among other things, once routed by the System, an order becomes subject to the rules and procedures of the destination market.<sup>12</sup>

Many other options exchanges, namely the CBOE, ISE, NYSE AMEX, Phlx, NOM and BOX, already have rules that are similar to the Professional designation rule proposed by the Exchange. The above noted exchanges make differentiations based on whether an order is marked Professional or otherwise. Some Options Members, including BATS Trading and the Exchange’s third-party routing broker-dealers, are, as noted, also members of other options

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<sup>11</sup> In contrast to BATS Options, hybrid options exchanges such as, for example, Phlx and CBOE blend auction and electronic market structures that differentiate certain order priority and execution functions based upon, among other things, the origin of the order (e.g., whether the order was a customer, market maker, broker or dealer, firm, or other type of order); these exchanges also charge different fees based on order origin. BATS Options does, like other exchanges, differentiate fees based on order origin. For example, fees for removing liquidity are different for customers than they are for market makers and firms. This filing does not propose any changes in respect of the BATS Options fee structure, though the Exchange does intend to file a proposal separately to adopt fees for Professional orders.

<sup>12</sup> Rule 21.1(b) states: “Orders sent by the System to other options exchanges do not retain time priority with respect to other orders in the System and the System shall continue to execute other orders while routed orders are away at another options exchange. Once routed by the System, an order becomes subject to the rules and procedures of the destination options exchange including, but not limited to, order cancellation. If a routed order is subsequently returned, in whole or in part, that order, or its remainder, shall receive a new time stamp reflecting the time of its return to the System.”

exchanges that have a Professional designation. As members of these exchanges, such Options Members are subject to their Professional designation rules. And, as mentioned previously, Exchange Rules indicate that orders routed by these broker-dealers become subject to the rules and procedures of the Away Exchanges.<sup>13</sup>

The Exchange believes that disparate rules with respect to Professional order designation, and lack of uniform application of such rules, do not promote the best regulation and may, in fact, encourage regulatory arbitrage.<sup>14</sup> The Exchange believes that it is therefore prudent and necessary to have a Professional designation rule as is commonplace in the industry, particularly where BATS Trading and the Exchange's third-party routing broker-dealers (like other Options Members) are members of several exchanges that have rules requiring Professional order designations.

#### The Proposal

The Exchange proposes new Rule 16.1(a)(45) to state that the term "Professional" means any person or entity that (i) is not a broker or dealer in securities, and (ii) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). Moreover, in order to properly represent orders entered on the Exchange according to the new definition, an Options Member will be required to appropriately mark all Professional orders.<sup>15</sup> To comply with this requirement, Options Members will be required to

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<sup>13</sup> Once routed by the System, an order becomes subject to the rules and procedures of the destination market including, but not limited to, order cancellation. See Rule 21.9.

<sup>14</sup> The Exchange believes that the risk of regulatory arbitrage is heightened where not all exchanges have Professional designation rules; and there is a lack of uniformity regarding Professional Rule Exchanges marking orders as Professional when routing such orders away.

<sup>15</sup> The Exchange intends to require Members to identify Professional orders submitted electronically, and will separately notify its Members regarding this requirement.

review their Public Customers' activity on at least a quarterly basis to determine whether orders that are not for the account of a broker-dealer should be represented as Professional orders.<sup>16</sup>

Upon publication of the notice regarding this proposal, the Exchange will issue a notice to Options Members providing them at least ten business days notice of the procedures for the implementation of the proposal.

The Professional definition proposed by BATS Options is similar to the Professional designation that has been adopted by BOX, NOM, Phlx, ISE, CBOE, and NYSE Amex.<sup>17</sup> As noted, the Professional definition will not impact the Exchange's price/time order entry (priority) system.<sup>18</sup> Instead, the Exchange's proposal will ensure that Options Members mark their Professional orders properly, that is, similarly in terms of Professional order identification regardless of whether the order is placed on BATS Options or some other another of the options exchanges with a Professional designation. Moreover, with the proposed Professional designation in place, the Exchange will be able to accept orders that are marked Professional.<sup>19</sup>

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<sup>16</sup> Members will be required to conduct a quarterly review and make any appropriate changes to the way in which they are representing orders within five business days after the end of each calendar quarter. While Members will only be required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a customer for which orders are being represented as other than Professional orders but that has averaged more than 390 orders per day during a month, the Exchange will notify the Member and the Member will be required to change the manner in which it is representing the customer's orders within five business days. This is similar to the process of other options exchanges that have adopted a Professional designation. See, e.g., Securities Exchange Act Release No. 61802 (March 30, 2010), 75 FR 17193 (April 5, 2010) (SR-Phlx-2010-05).

<sup>17</sup> See supra note 5.

<sup>18</sup> For example, unlike the Phlx proposal (which, among other things, discusses that Professional orders on Phlx will be treated in the same manner as off-floor brokers in terms of certain priority rules), the Exchange's proposal does not address or impact any priority relationship for Professional as opposed to other BATS Options orders.

<sup>19</sup> Currently, BATS Options only accepts orders that are marked as customer, firm, or market maker. While the Exchange does not intend to differentiate among Professional

The designation of an order as a Professional order would not result in any different treatment of such order for purposes of BATS Options rules concerning away order protection or routing to Away Exchanges. That is, all non broker or dealer orders, including those that meet the definition of Professional orders, would continue to be treated as Public Customers for purposes of the Exchange's rules regarding order protection and routing to Away Exchanges.<sup>20</sup>

The Exchange believes that identifying Professional accounts based upon the average number of orders entered in qualified accounts is an appropriately objective approach that will reasonably distinguish such persons and entities from retail investors or market participants. The Exchange proposes the threshold of 390 orders per day on average over a calendar month, because it believes that this number far exceeds the number of orders that are entered by retail investors in a single day.<sup>21</sup> Moreover, the 390 orders per day threshold proposed by the Exchange directly corresponds to the daily order volume recognized by Phlx, NOM, ISE, and

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and other orders for priority purposes, it may, in the future, feel that it is appropriate to differentiate its routing or other fees in respect of Professional as opposed to other orders; and if so, the Exchange intends to file an appropriate fee-related rule filing(s). The Exchange does not address its fee structure in the present filing.

<sup>20</sup> See, e.g., Rule 21.9 and Chapter XXVII.

<sup>21</sup> 390 orders is equal to the total number of orders that a person would place in a day if that person entered one order every minute from market open to market close. Many of the largest retail-oriented electronic brokers offer lower commission rates to customers they define as "active traders." Publicly available information from the websites of Charles Schwab, Fidelity, TD Ameritrade and OptionsXpress all define "active trader" as someone who executes only a few options trades per month. The highest required trading activity to qualify as an active trader among these four firms was 35 trades per quarter. See note 11 of Securities Exchange Act Release No. 57254 (February 1, 2008), 73 FR 7345, 7347 (SR-ISE-2006-26) (which also notes that a study of one of the largest retail-oriented options brokerage firms indicated that on a typical trading day, options orders were entered with respect to 5,922 different customer accounts. There was only one order entered with respect to 3,765 of the 5,922 different customer accounts on this day, and there were only 17 customer accounts with respect to which more than ten orders were entered. The highest number of orders entered with respect to any one account over the course of an entire week was 27).

other options exchanges that have, as previously discussed, established Professional order designations.<sup>22</sup> In addition, basing the standard on the number of orders that are entered in listed options for a qualified account(s) assures that Professional account holders cannot inappropriately avoid the purpose of the rule by spreading their trading activity over multiple exchanges, and using an average number over a calendar month will prevent gaming of the 390 order threshold.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>23</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>24</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanisms of a free and open market and a national market system, by defining Professional and indicating that all Professional orders shall be appropriately marked by Options Members. The Exchange believes that the proposal is particularly consistent with Section 6(b)(5) of the Act,<sup>25</sup> with respect to removal of impediments to, and perfection the mechanism of, a free and open market and a national market system, because the proposed changes will provide for consistent regulation for Options Members that are members of other SROs with analogous rules, as described above.

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<sup>22</sup> The similarity of the Exchange's proposed Professional order definition to that of other options exchanges is important from the regulatory perspective, that is from a desire to promote a national market system that minimizes regulatory arbitrage.

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

<sup>24</sup> 15 U.S.C. 78f(b)(5).

<sup>25</sup> Id.

Further, the Exchange believes that disparate rules regarding Professional order designation, and a lack of uniform application of such rules, do not promote the best regulation and may, in fact, encourage regulatory arbitrage. The Exchange believes that it is therefore prudent and necessary to have a Professional designation rule as is commonplace in the industry, particularly where BATS Trading or the Exchange's third-party routing broker-dealers (like other Options Members) are members of several exchanges that have rules requiring Professional order designations. The designation of Professional orders would not result in any different treatment of such orders for purposes of the Exchange's Rules concerning order protection or routing to Away Exchanges. That is, all non broker or dealer orders, including those that meet the definition of Professional orders, would continue to be treated as Public Customers for purposes of the Exchange's Rules regarding order protection and routing to Away Exchanges. As such, the Exchange believes the proposed rule change is consistent with the Act.

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

The Exchange does not believe that the proposed rule change imposes any burden on competition.

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: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time

as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>26</sup> and Rule 19b-4(f)(6)(iii) thereunder.<sup>27</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 necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change 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 Number SR-BATS-2011-041 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-2011-041. 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

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

<sup>27</sup> 17 CFR 240.19b-4(f)(6).

comments on the Commission's Internet website (<http://www.sec.gov/rules/sro/shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 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-2011-041 and should be submitted on or before [insert date 21 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>28</sup>

Elizabeth M. Murphy  
Secretary

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<sup>28</sup> 17 CFR 200.30-3(a)(12).