

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-67165; File No. SR-BATS-2012-021)

June 8, 2012

Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by BATS Exchange, Inc. to Adopt Rules Related to Risk Management Functionality for BATS Options

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 June 1, 2012, 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 proposes to adopt Rule 21.16, entitled “Risk Monitor Mechanism”, to codify the risk monitoring functionality offered to all Users<sup>5</sup> of the BATS equity options trading platform (“BATS Options”).

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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 website 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 change is to reflect in the Exchange's rules that Users are able to establish certain risk control parameters. Specifically, the Exchange proposes to adopt new Rule 21.16, Risk Monitor Mechanism, which is similar to NASDAQ Options Market ("NOM") Chapter VI, Section 19 and the rules of other options exchanges (as explained in detail below). The Risk Monitor Mechanism provides protection from the risk of multiple executions across multiple series of an option or across multiple options. The risk to Users is not limited to a single series in an option or even to all series of an option; Users that quote in multiple series of multiple options have significant exposure, requiring them to offset or hedge their overall positions.

In particular, the Risk Monitor Mechanism will be useful for market makers on BATS Options ("Market Makers"), who are required to continuously quote in assigned options. Quoting across many series in an option creates the possibility of "rapid fire"

executions that can create large, unintended principal positions that expose the Market Maker to unnecessary market risk. The Risk Monitor Mechanism is intended to assist such Users in managing their market risk.

Though the Risk Monitor Mechanism will be most useful to Market Makers, the Exchange proposes to offer the functionality to all participant types. There are other firms that trade on a proprietary basis and provide liquidity to the Exchange; these firms could potentially benefit, similarly to Market Makers, from the Risk Monitor Mechanism. The Exchange believes that the Risk Monitor Mechanism should help liquidity providers generally, market makers and other participants alike, in managing risk and providing deep and liquid markets to investors.

Pursuant to new Rule 21.16, the Risk Monitor Mechanism operates by the System maintaining a counting program for each User. As proposed, a single User may configure a single counting program or multiple counting programs to govern its trading activity (i.e., on a per 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 will commence for an option when a transaction occurs in any series in such option. The counting program will count 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 will also count a User’s executions, contract volume and notional value across all options which a User trades (“Firm Category”). For the

purposes of new Rule 21.16, 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 will engage 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 (as defined below) 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 new Rule 21.16. Similarly, when a Specified Engagement Trigger is reached in the Firm Category, the Risk Monitor Mechanism will automatically remove such User's orders in all series of all options and reject any additional orders from a User until the counting program has been reset in accordance with paragraph (d) of new Rule 21.16. The Risk Monitor Mechanism will also attempt to cancel any orders that have been routed away to other options exchanges on behalf of the User.

As provided in proposed subparagraph (b)(ii), 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>6</sup> (“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.

For example, assume a User is quoting orders in several series of a particular option issue, and sets Specified Engagement Triggers in an Options Category as follows: (i) a volume trigger at 500 contracts per second, (ii) a count trigger at 100 executions per minute, and (iii) an absolute notional value trigger of \$30,000. In this example, there are three Specified Engagement Triggers for the option issue, any one of which, if reached, would result in cancellations of any additional orders of the User in the specified option issue, rejection of additional orders by the User in that issue and attempted cancellation of any orders in the option issue already routed to an away options exchange on behalf of the User. The following examples illustrate the operation of each of the User’s Specified Engagement Triggers:

Volume Specified Engagement Trigger in an Options Category

If within one second, executions against the User’s quotations in any series of front-month calls of the option issue equaled or exceeded 500 contracts, the Risk Monitor Mechanism would be engaged. To illustrate this example, assume the following

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<sup>6</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.

quotations and executions within the current second in front-month calls of the specified option issue:

<b>Price Level</b>	<b>Series 1 Quoted Size</b>	<b>Series 2 Quoted Size</b>	<b># Contracts Executed Series 1</b>	<b># Contracts Executed Series 2</b>
Level 1	100	50	100	50
Level 2	100	50	100	50
Level 3	150	50	150	0
Level 4	150	200	0	0
Level 5	150	200	0	0
Total	650	600	350	100

At this moment in time, the User has executed 450 contracts within the applicable second (350 contracts of Series 1 and 100 contracts of Series 2), which is less than the User's limit of 500 contracts per second. As such, the User's established volume trigger in an Options Category has not yet been reached. If, however, prior to the completion of the applicable second, an order executed against the User's Level 3 quotation in Series 2, the number of contracts executed in front-month calls of the option issue would be 500. The Risk Monitor would be engaged, and the User's remaining orders in all series of the option issue would be cancelled, additional orders by the User in that issue would be rejected, and the Exchange would attempt to cancel any orders in the option issue that had already been routed to an away options exchange on behalf of the User.

Execution Count Specified Engagement Trigger in an Options Category

If within one minute, executions against the User's quotations in any series of front-month puts of the option issue equaled or exceeded 100 executions per minute, the Risk Monitor Mechanism would be engaged. To illustrate this example, assume the following quotations and executions within the current minute in front-month puts of the specified option issue:

<b>Price Level</b>	<b># Executions Series 1</b>	<b># Executions Series 2</b>
Level 1	40	20
Level 2	20	15
Level 3	0	0
Total	60	35

At this moment in time, the User has received 95 total executions within the applicable minute (60 executions in Series 1 options and 35 executions in Series 2 options), which is less than the User's limit of 100 executions per minute. As such, the User's established count trigger in an Options Category has not yet been reached. If, however, prior to the completion of the applicable minute, the User executed 5 more orders in either series, the number of executions in front-month puts of the option issue would be 100. The Risk Monitor would be engaged, and the User's remaining orders in all series of the option issue would be cancelled, additional orders by the User in that issue would be rejected, and the Exchange would attempt to cancel any orders in the option issue that had already been routed to an away options exchange on behalf of the User.

Notional Value Specified Engagement Trigger in an Options Category

If, as of any time during the trading day, executions against the User's quotations in any series of front-month calls of the option issue equaled or exceeded a notional value of \$30,000, the Risk Monitor Mechanism would be engaged. To illustrate this example, assume the current notional value of all front-month calls in the option issue was \$29,900 as of 1:30 p.m. Eastern Time and the following executions occurred:

<b>Execution Number</b>	<b>Price</b>	<b>Number of Contracts</b>	<b>Series</b>	<b>Notional Value</b>
1	\$5.00	5	Series 1	\$25.00
2	\$3.00	15	Series 2	\$45.00

<b>Execution Number</b>	<b>Price</b>	<b>Number of Contracts</b>	<b>Series</b>	<b>Notional Value</b>
3	\$5.00	6	Series 1	\$30.00
			<b>Total</b>	<b>\$100.00</b>

At this moment in time, execution number 3 has raised the total notional value of all front-month calls to \$30,000 for the trading day. The Risk Monitor would be engaged, and the User's remaining orders in all series of the option issue would be cancelled, additional orders by the User in that issue would be rejected, and the Exchange would attempt to cancel any orders in the option issue that had already been routed to an away options exchange on behalf of the User.

As noted above, in addition to counting programs established across Options Categories, any of the available Specified Engagement Triggers are configurable on a Firm Category level as well (either as absolute limits or over a specified time period). When a Firm Category risk limit is triggered, then all options orders of a User are cancelled, additional orders by the User are rejected and the Exchange will attempt to cancel any orders already routed to an away options exchange on behalf of the User.

While the Risk Monitor Mechanism is a useful feature that serves an important risk management purpose, it operates consistent with the firm quote obligations of a broker-dealer pursuant to Rule 602 of Regulation NMS. Specifically, proposed paragraph (c) provides that any marketable orders or quotes that are executable against a User's quotation that are received prior to the time the Risk Monitor Mechanism is engaged will be automatically executed at the price up to the User's size, regardless of whether such an execution results in executions in excess of the User's Specified

Engagement Trigger. Accordingly, the Risk Monitor Mechanism cannot be used to circumvent a User's firm quote obligation.

If a User is quoting in two series of a particular option, at several price levels in each, and sets an Options Category volume trigger at 400 contracts, one contra side order can result in executions in excess of the Specified Engagement Trigger. Specifically, if a market order to sell 500 contracts is received in Series 1, the order will execute against the first four levels that the User is quoting, as follows:

<b>Price Level</b>	<b>Series 1 Size</b>	<b>Series 2 Size</b>	<b># Contracts Executed Series 1</b>	<b># Contracts Executed Series 2</b>
Level 1	100	50	100	0
Level 2	100	50	100	0
Level 3	150	100	150	0
Level 4	150	200	150	0
Level 5	150	200	0	0
Total	650	600	500	0

Although the User set a volume trigger at 400 contracts, the contra side order executes in its entirety and the Risk Protection Mechanism is engaged after the resulting executions have surpassed the Specified Engagement Trigger. The remaining quoted contracts in Series 1 and all quoted contracts in Series 2 would then be cancelled.

Proposed Rule 21.16(d) further provides that the system will reset the counting period for absolute limits when a User refreshes its risk limit thresholds. In addition, proposed Rule 21.16(d) provides that the System will reset the counting program and commence a new specified time period when: (i) A previous counting period has expired and a transaction occurs in any series in such option; or (ii) A User refreshes its risk limit thresholds prior to the expiration of the specified time period. For example, assume that a User has set Options Category limits for a particular option as follows: volume triggers

at 500 contracts per second and 20,000 contracts per minute, a count trigger at 20 executions per second, and an absolute notional value trigger of \$30,000. Assume that at a particular point in time, 400 front-month calls have executed in the current second, 19,000 front-month calls have executed in the current minute, 10 executions of front-month calls have occurred in the current second and a total of \$25,000 notional has been executed in front-month calls over the course of the trading day. Next, an incoming order from another User of BATS Options is received that results in another 1,000 front-month call contracts executing within the current minute, thus triggering the volume trigger of 20,000 contracts per minute. If the User reset the risk limit threshold, all values, including the absolute notional calculation for the trading day, would be reset to zero.

## 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>7</sup> Specifically, the proposed change is consistent with Section 6(b)(5) of the Act,<sup>8</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 functionality for Users to manage their risk. Offering of a Risk Monitor Mechanism will

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<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

allow Market Makers and other Users to quote aggressively which 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 NOM and other options exchanges.<sup>9</sup>

(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 Changes 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>10</sup> and Rule 19b-4(f)(6)(iii) thereunder.<sup>11</sup> In addition, the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change,

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<sup>9</sup> See NOM Chapter VI, Section 19; see also NASDAQ OMX PHLX Rule 1093; CBOE Rule 8.18; NYSE AMEX Options Rule 928; NYSE ARCA Options Rule 6.40.

<sup>10</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>11</sup> 17 CFR 240.19b-4(f)(6)(iii).

at least five business days prior to the date of filing, or such shorter time as designated by the Commission.<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 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 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-2012-021 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-2012-021. 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

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<sup>12</sup> Id.

(<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 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-2012-021 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).