

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68442; File No. SR-BATS-2012-046)

December 14, 2012

Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing of a Proposed Rule Change to Modify Exchange Rule 11.23 Relating to Auctions of Exchange-Listed Securities

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 December 6, 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, II, and III below, which Items have been prepared by the Exchange. 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 is filing with the Commission a proposal to amend Rule 11.23 entitled “Auctions” including to amend Rule 11.23(a)(6) to incorporate the Exchange’s clearly erroneous execution standards into the definition of Collar Price Range,<sup>3</sup> to amend Rule 11.23(a)(22) to provide that any portion of a market Regular Hours Only<sup>4</sup> (“RHO”) order will be cancelled immediately following any auction in which the order is not fully executed, to make changes to Rules 11.23(b)(2)(B), 11.23(c)(2)(B), and 11.23(d)(2)(C) to help to prevent the possibility of erroneous executions occurring in auctions on the Exchange, and to make changes to Rule 11.23(d)(2)(A) entitled “Publication of BATS Auction Information” in order to both make clear

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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> As defined in BATS Rule 11.23(a)(6).

<sup>4</sup> As defined in BATS Rule 11.23(a)(22).

that the rule should apply to IPO Auctions and to make a change to the data that will be disseminated by 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

Background

The Exchange recently proposed and received approval of rules governing auctions conducted on the Exchange for securities listed on the Exchange ("Exchange Auctions").<sup>5</sup> The Exchange adopted rules for conducting opening and closing auctions ("Opening Auctions" and "Closing Auctions," respectively) on the Exchange, an initial public offering auction (an "IPO Auction"), and an auction in the event of a halt of trading in the security (a "Halt Auction"). As mentioned above, the purpose of this filing is to amend the Exchange's rules to incorporate the Exchange's clearly erroneous execution standards into the definition of Collar Price Range, to

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<sup>5</sup> See Securities Exchange Act Release No. 65619 (October 25, 2011), 76 FR 67238 (October 31, 2011) (SR-BATS-2011-032).

make clear that the unexecuted portion of certain order types that do not participate in an auction will be cancelled immediately following the execution, to further prevent the possibility of erroneous executions occurring in auctions that occur on the Exchange, to make clear that certain requirements should apply to both IPO Auctions and Halt Auctions, and to make a change to the data that will be disseminated by the Exchange related to Exchange Auctions.

#### Collar Price Range

The Exchange proposes to amend Rule 11.23(a)(6) to amend the definition of “Collar Price Range” to incorporate the Exchange’s clearly erroneous execution standards into the definition of Collar Price Range. Specifically, the Exchange is proposing that the Collar Price Range will be based on the Exchange’s numerical guidelines for clearly erroneous executions, as detailed in Rule 11.17(c)(1). The Collar Price Range will be based on a collar midpoint which will be the Volume Based Tie Breaker<sup>6</sup> or, for an IPO Auction of an exchange traded product (“ETP”), the issuing price (both the “Collar Midpoint”)<sup>7</sup> and shall be determined as follows: where the Collar Midpoint is \$25.00 or less, the Collar Price Range shall be the range from 10% below the Collar Midpoint to 10% above the Collar Midpoint; where the Collar Midpoint is greater than \$25.00 but less than or equal to \$50.00, the Collar Price Range shall be the range from 5% below the Collar Midpoint to 5% above the Collar Midpoint; and where the Collar Midpoint is greater than \$50.00, the Collar Price Range shall be the range from 3% below the Collar Midpoint to 3% above the Collar Midpoint.

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<sup>6</sup> As defined in BATS Rule 11.23(a)(23).

<sup>7</sup> The Exchange notes that, because the Collar Price Range will be based on the Collar Midpoint and the numerical guidelines for clearly erroneous executions are based on the Reference Price, which is equal to the consolidated last sale immediately prior to the execution(s) under review, the modified Collar Price Range would not necessarily prevent all clearly erroneous executions from occurring.

The Exchange believes that this proposed change will provide greater transparency and certainty in Exchange Auctions by helping to reduce the possibility that an auction would occur at a price that would qualify as clearly erroneous under Rule 11.17(c)(1) and that may result in cancelled executions. As currently written, the Collar Price Range is set at 10% of the Volume Based Tie Breaker below and above the ZBB and ZBO, the NBB and NBO, or the Final Last Sale Eligible Trade, depending on market conditions at the time of the auction. In addition to helping to prevent auctions from occurring at prices that would qualify as clearly erroneous, the proposed change will also act to narrow the Collar Price Range, which will help limit the volatility in auction prices.

#### Market RHO Orders

The Exchange proposes to amend Rule 11.23(a)(22) to provide that any unexecuted portion of a market RHO order is immediately cancelled following any Exchange Auction in which it was eligible to participate, rather than being eligible for execution after the Exchange Auction. Specifically, the Exchange proposes that any portion of a market RHO order (a “Market RHO Auction Order”) will be cancelled immediately following any auction in which it is not executed. This proposed change would make clear that, consistent with the behavior of all other market orders entered on the Exchange, including market RHO orders entered on the Continuous Book, Market RHO Auction Orders would either execute immediately or be cancelled.

#### Determination of Auction Price

The Exchange proposes to amend Rules 11.23(b)(2)(B), 11.23(c)(2)(B), and 11.23(d)(2)(C) in order to help to protect against erroneous executions occurring in auctions on the Exchange. Specifically, the Exchange is proposing to amend its Rules related to the

determination of the auction price for Exchange Auctions such that where no limit orders from one or both sides would participate in the auction, the auction will occur at the price of the Volume Based Tie Breaker for Opening and Closing Auctions, the Final Last Sale Eligible Trade for Halt Auctions, and the issuing price for IPO Auctions.

Currently, BATS Rule 11.23 provides that where there is at least one limit order either: (i) on the Continuous Book or Auction Book for Opening and Closing Auctions; or (ii) among Eligible Auction Orders for IPO and Halt Auctions; then the auction will occur at the price level within the Collar Price Range, where applicable, that maximizes the number of shares executed in the auction. BATS Rule 11.23 also currently provides that where there are no limit orders: (i) on both the Continuous Book and the Auction Book for Opening and Closing Auctions; or (ii) among the Eligible Auction orders for IPO and Halt Auctions; then the auction will occur at a default price, which is based on the type of Auction occurring (the “Default Price”). Under the Exchange’s current rules, for Opening, Closing, and Halt Auctions, the Default Price is the Final Last Sale Eligible Trade. For IPO Auctions, the Default Price is the issuing price.

The proposed changes to Rule 11.23 are two-fold. First, the Exchange is proposing to amend its Rules such that, before determining the auction price, the Exchange will look to whether there is at least one limit order from each side that would participate in the auction, rather than, as currently implemented, looking to whether there is a single limit order either on the Continuous Book and Auction Book (for Opening and Closing Auctions) or among Eligible Auction Orders (for IPO and Halt Auctions). Where no limit orders from either or both sides would participate in the auction, the Exchange is proposing that the auction will occur at the price of the Default Price. By providing that the auction price will be the Default Price where no limit orders from one or both sides would participate in an Exchange Auction, this proposed

change would aid in price discovery and help to prevent erroneous executions by ensuring that a single limit order on one side of an auction that might not even participate in the Exchange Auction cannot on its own determine the auction price.

Secondly, the Exchange proposes to amend its Rules to change the Default Price for Opening and Closing Auctions. Currently, the Default Price for Opening and Closing Auctions is the price of the Final Last Sale Eligible Trade. Specifically, the Exchange is proposing to use the Volume Based Tie Breaker as the Default Price for Opening and Closing Auctions. Using the Volume Based Tie Breaker as the Default Price instead of the Final Last Sale Eligible Trade means that, by definition, the Exchange will look first to the ZBBO, then the NBBO to determine the auction price, and only where there is no ZBB or ZBO and no NBB or NBO will the Exchange use the Final Last Sale Eligible Trade as the auction price. This proposed change would aid in price discovery and help to reduce the likelihood of executions in auctions occurring at prices out of line with existing market conditions by using a Default Price that is based on current market conditions rather than a previous execution, the Final Last Sale Eligible Trade, to determine the auction price where no limit orders from one or both sides would participate in the auction.

In summary:

- Opening and Closing Auctions – Currently, in Opening and Closing Auctions, where there are no limit orders on both the Continuous Book and the Auction Book, the auction will occur at the price of the Final Last Sale Eligible Trade. The Exchange is proposing to change the current Opening and Closing Auction functionality such that, where no limit orders from either or both sides would participate in the auction, the auction will occur at the Volume Based Tie Breaker.

- IPO Auctions – Currently, in IPO Auctions, where there are no limit orders among the Eligible Auction Orders, the auction will occur at the issuing price. The Exchange is proposing to change the current IPO Auction functionality such that, where no limit orders from either or both sides would participate in the IPO Auction, the auction will occur at the issuing price.
- Halt Auctions – Currently, in Halt Auctions, where there are no limit orders among the Eligible Auction Orders, the auction will occur at the Final Last Sale Eligible Trade. The Exchange is proposing to change the current Halt Auction functionality such that, where no limit orders from either or both sides would participate in the Halt Auction, the auction will occur at the price of the Final Last Sale Eligible Trade.

#### Publication of BATS Auction Information

The Exchange proposes to amend Rule 11.23(d)(2)(A) entitled “Publication of BATS Auction Information” in order to both make clear that the rule should also apply to IPO Auctions, not just Halt Auctions, and to make a change to the data that will be disseminated. Specifically, the Exchange proposes to add a reference to IPO Auctions to the rule and to disseminate the lesser of the Reference Buy Shares and the Reference Sell Shares rather than to disseminate both pieces of information, in order to more effectively prevent the possibility of gaming.

The Exchange is proposing to amend Rule 11.23(d)(2)(A) to disseminate the lesser of the Reference Buy Shares and the Reference Sell Shares in an effort to prevent possible gaming of IPO Auctions and Halt Auctions. Specifically, the Exchange is concerned that market participants could use information in the auction information messages to manipulate the auction. Where an auction information message for an IPO or Halt Auction contains both

Reference Buy Shares and Reference Sell Shares, a User knows the exact amount of liquidity available at a given price level on both sides of the Auction Book simultaneously. In IPO and Halt Auctions, orders can be entered up until the auction occurs, which would allow a User to use that information to knowingly move the price of the auction by entering and/or cancelling sufficiently sized orders, assuming that there is at least one share of contra-side liquidity at the next price level.

As proposed, the auction information message for IPO and Halt Auctions would only contain the lesser of the Reference Buy Shares and Reference Sell Shares and, therefore, a User would never have complete knowledge of liquidity available on both sides of the book simultaneously. This lack of full information will prevent Users from knowing exactly how the auction will react to an order that they enter, thus helping to prevent gaming of IPO and Halt Auctions.

These gaming concerns do not exist for Opening and Closing Auctions because the auction information messages for the Opening and Closing Auctions do not include information relating to the Continuous Book, so information disseminated in the auction information messages does not provide complete information about the auction. This prevents Users from knowing exactly how the auction will react to an order that they enter. In addition, auction information messages are not disseminated until after the point in time that Eligible Auction Orders cannot be modified or cancelled and only Late Limit on Open Orders<sup>8</sup> and Late Limit on Close Orders<sup>9</sup> (collectively, “Late Orders”) can be entered. Specifically, in Opening and Closing Auctions, auction information messages are not disseminated until two minutes and five minutes prior to the auction (the “Cutoff”), respectively, at which point Users may not modify or cancel

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<sup>8</sup> As defined in BATS Rule 11.23(a)(12).

<sup>9</sup> As defined in BATS Rule 11.23(a)(11).

any Eligible Auction Orders entered onto the Auction Book. After the Cutoff, Users may only enter Late Orders onto the Auction Book. Late Orders cannot be modified or cancelled by the User after entry and can only be priced as aggressively as the ZBB for bids and the ZBO for offers, the NBB or NBO where there is no ZBBO, or the limit price of the order where there is no ZBBO and NBBO. In the absence of a ZBBO and NBBO a Late Order could be entered without price restriction, however, because there may be hidden liquidity on the Continuous Book, the User could not be certain of how the order would affect the auction.

## 2. Statutory Basis

The Exchange believes that its proposal 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>10</sup> In particular, the proposal is consistent with Section 6(b)(5) of the Act,<sup>11</sup> because it would 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 interest. Specifically, the Exchange believes that the proposed changes will improve the price discovery process for securities listed on the Exchange along with reducing the likelihood that erroneous executions will occur in auctions conducted on the Exchange by ensuring that a single limit order on one side of an auction that might not even participate in the Exchange Auction cannot on its own determine the auction price. Instead, the Exchange is proposing that where there are no limit orders on either or both sides that would participate in an Exchange Auction, the auction price would be the Default Price. The Exchange further believes that the proposed changes will improve the price discovery process by changing the Default Price for Opening and Closing

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<sup>10</sup> 15 U.S.C. 78f(b).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

Auctions from the Final Last Sale Eligible Trade to the Volume Based Tie Breaker, which will, by definition, mean that the Exchange will look to current market conditions rather than a previous execution to determine the auction price where no limit orders from one or both sides would participate in the auction. In addition, the Exchange believes that the proposed changes will provide greater transparency and certainty in Exchange Auctions by helping to reduce the possibility that an auction would occur at a price that would qualify as clearly erroneous under Rule 11.17(c)(1) and that may result in cancelled executions. Further, the Exchange believes that the proposed change will provide greater transparency and certainty in Exchange Auctions by helping to limit the volatility in auction prices by narrowing the Collar Price Range. The Exchange also believes that the proposed changes will help prevent fraudulent and manipulative acts and practices along with, in general, protecting investors and the public interest by changing the auction information messages disseminated by the Exchange during IPO and Halt Auctions to include only the lesser of the Reference Buy Shares and the Reference Sell Shares, which will more help to prevent the possibility of gaming in the auctions, as described above. Lastly, the Exchange believes that the proposed changes will provide greater clarity and transparency by making clear that any portion of a Market RHO Auction Order will be cancelled immediately following any auction in which it is not executed, behavior that is consistent with the behavior of all other market orders entered on the Exchange.

(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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

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 Exchange 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-2012-046 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-2012-046. 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, 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 the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer

to File Number SR-BATS-2012-046 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

Kevin M. O'Neill  
Deputy Secretary

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