

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69331; File No. SR-BATS-2013-016)

April 5, 2013

Self-Regulatory Organizations; BATS Exchange, Inc.; Order Approving, on an Accelerated Basis, Proposed Rule Change to Modify the BATS Options Market Maker Obligation Rule

I. Introduction

On March 1, 2013, BATS Exchange, Inc. (the “Exchange” or “BATS”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (“Act”),² and Rule 19b-4 thereunder,³ a proposed rule change to modify the BATS Options Market (“BATS Options”) Market Maker obligation rule. The proposed rule change was published for comment in the Federal Register on March 12, 2013.⁴ The Commission received no comment letters on the proposal. This order approves the proposed rule change on an accelerated basis.

II. Background

On May 6, 2010, the U.S. equity markets experienced a severe disruption that, among other things, resulted in the prices of a large number of individual securities suddenly declining by significant amounts in a very short time period before suddenly reversing to prices consistent with their pre-decline levels.⁵ This severe price volatility led to a large number of trades being

¹ 15 U.S.C. 78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

⁴ See Securities Exchange Act Release No. 69038 (March 5, 2013), 78 FR 15773.

⁵ The events of May 6 are described more fully in a joint report by the staffs of the Commodity Futures Trading Commission (“CFTC”) and the Commission. See Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues, “Findings Regarding the Market Events of May 6, 2010,” dated September 30, 2010, available at <http://www.sec.gov/news/studies/2010/marketevents-report.pdf>.

executed at temporarily depressed prices, including many that were more than 60% away from pre-decline prices. One response to the events of May 6, 2010, was the development of the single-stock circuit breaker pilot program, which was implemented through a series of rule filings by the equity exchanges and by FINRA.⁶ The single-stock circuit breaker was designed to reduce extraordinary market volatility in NMS stocks by imposing a five-minute trading pause when a trade was executed at a price outside of a specified percentage threshold.⁷

To replace the single-stock circuit breaker pilot program, the equity exchanges filed a National Market System Plan⁸ pursuant to Section 11A of the Act,⁹ and Rule 608 thereunder,¹⁰ which featured a “limit up-limit down” mechanism (as amended, the “Limit Up-Limit Down Plan” or “Plan”).

⁶ For further discussion on the development of the single-stock circuit breaker pilot program, see Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (“Limit Up-Limit Down Plan” or “Plan”).

⁷ See Securities Exchange Act Release Nos. 62884 (September 10, 2010), 75 FR 56618 (September 16, 2010) and Securities Exchange Act Release No. 62883 (September 10, 2010), 75 FR 56608 (September 16, 2010) (SR-FINRA-2010-033) (describing the “second stage” of the single-stock circuit breaker pilot) and Securities Exchange Act Release No. 64735 (June 23, 2011), 76 FR 38243 (June 29, 2011) (describing the “third stage” of the single-stock circuit breaker pilot).

⁸ NYSE Euronext filed on behalf of New York Stock Exchange LLC (“NYSE”), NYSE Amex LLC (“NYSE Amex”), and NYSE Arca, Inc. (“NYSE Arca”), and the parties to the proposed National Market System Plan, BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Incorporated (“CBOE”), Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, the Nasdaq Stock Market LLC, and National Stock Exchange, Inc. (collectively with NYSE, NYSE MKT, and NYSE Arca, the “Participants”). On May 14, 2012, NYSE Amex filed a proposed rule change on an immediately effective basis to change its name to NYSE MKT LLC (“NYSE MKT”). See Securities Exchange Act Release No. 67037 (May 21, 2012) (SR-NYSEAmex-2012-32).

⁹ 15 U.S.C. 78k-1.

¹⁰ 17 CFR 242.608.

The Plan sets forth requirements that are designed to prevent trades in individual NMS stocks from occurring outside of the specified price bands. The price bands consist of a lower price band and an upper price band for each NMS stock. When one side of the market for an individual security is outside the applicable price band, i.e., the National Best Bid is below the Lower Price Band, or the National Best Offer is above the Upper Price band, the Processors¹¹ are required to disseminate such National Best Bid or National Best Offer¹² with a flag identifying that quote as non-executable. When the other side of the market reaches the applicable price band, i.e., the National Best Offer reaches the lower price band, or the National Best Bid reaches the upper price band, the market for an individual security enters a 15-second Limit State, and the Processors are required disseminate such National Best Offer or National Best Bid with an appropriate flag identifying it as a Limit State Quotation. Trading in that stock would exit the Limit State if, within 15 seconds of entering the Limit State, all Limit State Quotations were executed or canceled in their entirety. If the market does not exit a Limit State within 15 seconds, then the Primary Listing Exchange will declare a five-minute trading pause, which is applicable to all markets trading the security.

The Primary Listing Exchange may also declare a trading pause when the stock is in a Straddle State, i.e., the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band and the NMS Stock is not in a Limit State. In order to declare a trading pause in this scenario, the Primary Listing Exchange must determine that trading in that stock deviates from normal

¹¹ As used in the Plan, the Processor refers to the single plan processor responsible for the consolidation of information for an NMS Stock pursuant to Rule 603(b) of Regulation NMS under the Exchange Act. See id.

¹² “National Best Bid” and “National Best Offer” has the meaning provided in Rule 600(b)(42) of Regulation NMS under the Exchange Act. See id.

trading characteristics such that declaring a trading pause would support the Plan's goal to address extraordinary market volatility.¹³

On May 31, 2012, the Commission approved the Plan as a one-year pilot, which shall be implemented in two phases.¹⁴ The first phase of the Plan shall be implemented beginning April 8, 2013.¹⁵

III. Description of the Proposal

In light of and in connection with the Limit Up-Limit Down Plan, BATS is amending Rule 22.6(d) to suspend the obligation of Market Makers registered with BATS Options to enter continuous bids and offers during a halt, suspension, or pause in trading of the underlying security.

Currently, under Rule 22.6(d), BATS Options requires Market Makers to enter continuous bids and offers for the options series to which it is registered in at least 75% of the options series in which the Market Maker is registered. The Exchange's proposal would suspend

¹³ As set forth in more detail in the Plan, all trading centers would be required to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for an NMS Stock. The Processors would be able to disseminate an offer below the Lower Price Band or bid above the Upper Price Band that nevertheless may be inadvertently submitted despite such reasonable policies and procedures, but with an appropriate flag identifying it as non-executable; such bid or offer would not be included in National Best Bid or National Best Offer calculations. In addition, all trading centers would be required to develop, maintain, and enforce policies and procedures reasonably designed to prevent trades at prices outside the price bands, with the exception of single-priced opening, reopening, and closing transactions on the Primary Listing Exchange.

¹⁴ See "Limit Up-Limit Down Plan," supra note 6. See also Securities Exchange Act Release No. 68953 (February 20, 2013), 78 FR 13113 (February 26, 2013) (Second Amendment to Limit Up-Limit Down Plan by BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Inc., et al.) and Securities Exchange Act Release No. 69062 (March 7, 2013), 78 FR 15757 (March 12, 2013) (Third Amendment to Limit Up-Limit Down Plan by BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Inc., et al.)

¹⁵ See "Second Amendment to Limit Up-Limit Down Plan," supra note 14.

a Market Maker’s continuous quoting obligation for the duration that an underlying NMS stock is in a Limit State or a Straddle State. The Exchange’s proposal would also suspend those obligations during a trading halt, suspension, or pause (collectively, a “Trading Halt”) in the underlying security. Following a trading halt, the market maker’s quoting obligations would only resume following the first regular-way transaction on the primary listing market in the underlying security.

IV. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to a national securities exchange.¹⁶ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹⁷ which, among other things, requires a national securities exchange to be so organized and have the capacity to be able to carry out the purposes of the Act and to enforce compliance by its members and persons associated with its members with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange, and 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 regulation, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

¹⁶ In approving the proposed rule changes, the Commission has considered their impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁷ 15 U.S.C. 78f(b).

The Commission finds that the proposal to suspend a Market Maker's obligations when the underlying security is in a limit up-limit down state is consistent with the Act. When the underlying is in a Limit or Straddle State or is subject to a Trading Halt,¹⁸ there may not be a reliable price for the underlying security to serve as a benchmark for market makers to price options. In addition, the absence of an executable bid or offer for the underlying security will make it more difficult for market makers to hedge the purchase or sale of an option. Given these significant changes to the normal operating conditions of market makers, the Commission finds that the Exchange's decision to suspend a Market Maker's obligations in these limited circumstances is consistent with the Act.

The Commission notes, however, that the Plan was approved on a pilot basis and its Participants will monitor how it is functioning in the equity markets during the pilot period. To this end, the Commission expects that, upon implementation of the Plan, the Exchange will continue monitoring the quoting requirements that are being amended in this proposed rule change and determine if any necessary adjustments are required to ensure that they remain consistent with the Act.

In addition, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act¹⁹ for approving the proposed rule change on an accelerated basis. The proposal is in part related to the Plan, which will become operative on April 8, 2013.²⁰ Without accelerated approval, the proposed rule change, and any attendant benefits, would take effect after the Plan's

¹⁸ The Commission notes that, pursuant to BATS Rule 20.5, BATS will halt trading in the option when the trading in the underlying is halted as a result of a circuit breaker. Therefore, the proposal to suspend market maker quoting obligations when the underlying is subject to a trading halt would apply to other, non-circuit breaker-related instances when the underlying is no longer trading, but, pursuant to Rule 20.3, BATS has elected to continue trading the overlying option.

¹⁹ 15 U.S.C. 78s(b)(2)

²⁰ See supra note 15.

implementation date. Accordingly, the Commission finds that good cause exists for approving the proposed rule change on an accelerated basis.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act²¹ that the proposed rule change (SR-BATS-2013-016) is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²²

Kevin M. O'Neill
Deputy Secretary

²¹ 15 U.S.C. 78f(b)(2).

²² 17 CFR 200.30-3(a)(12).