

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-81992; File No. SR-BatsEDGX-2017-43)

October 31, 2017

Self-Regulatory Organizations; Cboe EDGX Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend Rule 20.6, Nullification and Adjustment of Options Transactions including Obvious Errors

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 October 25, 2017, Cboe EDGX Exchange, Inc. (“EDGX” or the “Exchange”) (formerly known as Bats EDGX Exchange, Inc.) 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) 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 to amend Rule 20.6, entitled “Nullification and Adjustment of Options Transactions including Obvious Errors.” Rule 20.6 relates to the adjustment and nullification of transactions that occur on the Exchange’s equity options platform (“EDGX Options”).

The text of the proposed rule change is available at the Exchange’s website at

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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).

[www.bats.com](http://www.bats.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 proposes to amend Exchange Rule 20.6 to add Interpretation and Policy .04 (the "Proposed Rule"). This filing is based on a proposal recently submitted by Cboe Exchange, Inc. ("Cboe Options") and approved by the Securities and Exchange Commission (the "Commission").<sup>5</sup>

In 2015, the U.S. options exchanges adopted a new, harmonized rule related to the adjustment and nullification of erroneous options transactions, including a specific provision related to coordination in connection with large-scale events involving erroneous options transactions.<sup>6</sup> The Exchange launched an options exchange later that year, with the newly

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<sup>5</sup> See Securities Exchange Act Release 80040 (February 14, 2017), 82 FR 11248 (February 21, 2017) (Order Approving SR-CBOE-2016-088).

<sup>6</sup> See Securities Exchange Act Release Nos. 74556 (March 20, 2015), 80 FR 16031 (March 26, 2015) (SR-BATS-2014-067); see also Securities Exchange Act Release No. 73884 (December 18, 2014), 79 FR 77557 (December 24, 2014) (the "Initial Filing"); 81084

harmonized rule as part of the original rule set.<sup>7</sup> The Exchange believes that the changes the options exchanges implemented with the new, harmonized rule have led to increased transparency and finality with respect to the adjustment and nullification of erroneous options transactions. However, as part of the initial initiative, the Exchange and other options exchanges deferred a few specific matters for further discussion.

Specifically, the options exchanges continued working together to identify ways to improve the process related to the adjustment and nullification of erroneous options transactions as it relates to complex orders<sup>8</sup> and stock-option orders. The goal of the process undertaken by the options exchanges was to further harmonize rules related to the adjustment and nullification of erroneous options transactions. As described below, the Exchange believes that the changes the options exchanges proposed, and the Exchange now proposes, will provide transparency and finality with respect to the adjustment and nullification of erroneous complex order.<sup>9</sup>

Particularly, the proposed changes seek to achieve consistent results for participants across U.S. options exchanges while maintaining a fair and orderly market, protecting investors and protecting the public interest.

The Proposed Rule is based on this coordinated effort and reflects discussions by the options exchanges whereby the exchanges that offer complex orders and/or stock-option orders agreed to universally adopt new provisions that the options exchanges collectively believe will improve the handling of erroneous options transactions that result from the execution of complex

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(July 6, 2017), 82 FR 32216 (July 12, 2017) (SR-BatsBZX-2017-35) (adopting subsequent harmonized provisions relating to the calculation of Theoretical Price).

<sup>7</sup> See Securities Exchange Act Release No. 75650 (August 7, 2015), 80 FR 48600 (August 13, 2015) (SR- EDGX-2015-18).

<sup>8</sup> See Rule 21.20(a)(5) (defining complex orders).

<sup>9</sup> The Exchange is not proposing to adopt changes to the obvious error rule related to stock-option orders at this time because it does not currently accept stock-option orders.

orders and stock-option orders. An exchange that does not offer complex orders and/or stock-option orders will not adopt these new provisions until such time as the exchange offers complex orders and/or stock-option orders. Although the Exchange was involved in the discussions by options exchanges to propose a uniform rule, the Exchange has not historically offered complex orders or stock-option orders, and thus, has not previously adopted rules applicable to such orders. The Exchange is filing this proposal at this time in anticipation of launching a complex order book that will accept complex orders in the near future.<sup>10</sup> The Exchange is not proposing to adopt changes to the obvious error rule related to stock-option orders at this time, as the Exchange does not currently accept stock-option orders and does not have a near term expectation to accept such orders.

The Exchange believes that the Proposed Rule supports an approach consistent with long-standing principles in the options industry under which the general policy is to adjust rather than nullify transactions. The Exchange acknowledges that adjustment of transactions is contrary to the operation of analogous rules applicable to the equities markets, where erroneous transactions are typically nullified rather than adjusted and where there is no distinction between the types of market participants involved in a transaction. For the reasons set forth below, the Exchange believes that the distinctions in market structure between equities and options markets continue to support these distinctions between the rules for handling obvious errors in the equities and options markets.

Various general structural differences between the options and equities markets point toward the need for a different balancing of risks for options market participants and are reflected in this proposal. Option pricing is formulaic and is tied to the price of the underlying

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<sup>10</sup> See Securities Exchange Act Release No. 81891 (October 17, 2017) (SR-BatsEDGX-2017-29) (order approving rules for EDGX complex order book).

stock, the volatility of the underlying security and other factors. Because options market participants can generally create new open interest in response to trading demand, as new open interest is created, correlated trades in the underlying or related series are generally also executed to hedge a market participant's risk. This pairing of open interest with hedging interest differentiates the options market specifically (and the derivatives markets broadly) from the cash equities markets. In turn, the Exchange believes that the hedging transactions engaged in by market participants necessitates protection of transactions through adjustments rather than nullifications when possible and otherwise appropriate.

The options markets are also quote driven markets dependent on liquidity providers to an even greater extent than equities markets. In contrast to the approximately 7,000 different securities traded in the U.S. equities markets each day, there are more than 500,000 unique, regularly quoted option series. Given this breadth in options series the options markets are more dependent on liquidity providers than equities markets; such liquidity is provided most commonly by registered market makers but also by other professional traders. With the number of instruments in which registered market makers must quote and the risk attendant with quoting so many products simultaneously, the Exchange believes that those liquidity providers should be afforded a greater level of protection. In particular, the Exchange believes that liquidity providers should be allowed protection of their trades given the fact that they typically engage in hedging activity to protect them from significant financial risk to encourage continued liquidity provision and maintenance of the quote-driven options markets.

In addition to the factors described above, there are other fundamental differences between options and equities markets which lend themselves to different treatment of different classes of participants that are reflected in this proposal. For example, there is no trade reporting

facility in the options markets. Thus, all transactions must occur on an options exchange. This leads to significantly greater retail customer participation directly on exchanges than in the equities markets, where a significant amount of retail customer participation never reaches the Exchange but is instead executed in off-exchange venues such as alternative trading systems, broker-dealer market making desks and internalizers. In turn, because of such direct retail customer participation, the exchanges have taken steps to afford those retail customers - generally Priority Customers - more favorable treatment in some circumstances.

### Complex Orders

As more fully described below, the Proposed Rule applies much of current Rule 20.6 (the “Current Rule”) to complex orders.<sup>11</sup> The Proposed Rule deviates from the Current Rule only to account for the unique qualities of complex orders. The Proposed Rule reflects the fact that complex orders can execute against other complex orders or can execute against individual simple orders in the leg markets. When a complex order executes against the leg markets there may be different counterparties on each leg of the complex order, and not every leg will necessarily be executed at an erroneous price. In order to apply the Current Rule and account for the unique characteristics of complex orders, proposed Interpretation and Policy .04 is split into two parts—paragraphs (a) and (b).

First, proposed Interpretation and Policy .04(a) governs the review of complex orders that are executed against individual legs (as opposed to a complex order that executes against another complex order).<sup>12</sup> Proposed Interpretation and Policy .04(a) provides:

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<sup>11</sup> In order for a complex order to qualify as an obvious or catastrophic error at least one of the legs must itself qualify as an obvious or catastrophic error under the Current Rule. See Proposed Rule .04(a)-(b).

<sup>12</sup> The leg market consists of quotes and/or orders in single options series. A complex order may be received by the Exchange electronically, and the legs of the complex order may

If a complex order executes against individual legs and at least one of the legs qualifies as an Obvious Error under paragraph (c)(1) or a Catastrophic Error under paragraph (d)(1), then the leg(s) that is an Obvious or Catastrophic Error will be adjusted in accordance with paragraphs (c)(4)(A) or (d)(3), respectively, regardless of whether one of the parties is a Customer. However, any Customer order subject to this paragraph (a) will be nullified if the adjustment would result in an execution price higher (for buy transactions) or lower (for sell transactions) than the Customer's limit price on the complex order or individual leg(s). If any leg of a complex order is nullified, the entire transaction is nullified.

As previously noted, at least one of the legs of the complex order must qualify as an obvious or catastrophic error under the Current Rule in order for the complex order to receive obvious or catastrophic error relief. Thus, when the Exchange is notified (within the timeframes set forth in paragraph (c)(2) or (d)(2)) of a complex order that is a possible obvious error or catastrophic error, the Exchange will first review the individual legs of the complex order to determine if one or more legs qualify as an obvious or catastrophic error.<sup>13</sup> If no leg qualifies as an obvious or catastrophic error, the transaction stands—no adjustment and no nullification.

Reviewing the legs to determine whether one or more legs qualify as an obvious or catastrophic error requires the Exchange to follow the Current Rule. In accordance with paragraphs (c)(1) and (d)(1) of the Current Rule, the Exchange compares the execution price of each individual leg to the Theoretical Price of each leg (as determined by paragraph (b) of the Current Rule). If the execution price of an individual leg is higher or lower than the Theoretical Price for the series by an amount equal to at least the amount shown in the obvious error table in paragraph (c)(1) of the Current rule or the catastrophic error table in paragraph (d)(1) of the

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have different counterparties. For example, Market-Maker 1 may be quoting in ABC calls and Market-Maker 2 may be quoting in ABC puts. A complex order to buy the ABC calls and puts may execute against the quotes of Market-Maker 1 and Market-Maker 2.

<sup>13</sup> Because a complex order can execute against the leg market, the Exchange may also be notified of a possible obvious or catastrophic error by a counterparty that received an execution in an individual options series. If upon review of a potential obvious error the Exchange determines an individual options series was executed against the leg of a complex order, proposed Interpretation and Policy .04(a) will govern.

Current Rule, the individual leg qualifies as an obvious or catastrophic error, and the Exchange will take steps to adjust or nullify the transaction.<sup>14</sup>

To illustrate, consider a Customer submits a complex order to the Exchange consisting of leg 1 and leg 2—Leg 1 is to buy 100 ABC calls and leg 2 is to sell 100 ABC puts. Also, consider that Market-Maker 1 is quoting the ABC calls \$1.00-1.20 and Market-Maker 2 is quoting the ABC puts \$2.00-2.20. If the complex order executes against the quotes of Market-Makers 1 and 2, the Customer buys the ABC calls for \$1.20 and sells the ABC puts for \$2.00. As with the obvious/catastrophic error reviews for simple orders, the execution price of leg 1 is compared to the Theoretical Price<sup>15</sup> of Leg 1 in order to determine if Leg 1 is an obvious error under paragraph (c)(1) of the Current Rule or a catastrophic error under paragraph (d)(1) of the Current Rule. The same goes for Leg 2. The execution price of Leg 2 is compared to the Theoretical Price of Leg 2. If it is determined that one or both of the legs are an obvious or catastrophic error, then the leg (or legs) that is an obvious or catastrophic error will be adjusted in accordance with paragraphs (c)(4)(A) or (d)(3) of the Current Rule, regardless of whether one of the parties is a Customer.<sup>16</sup> Although a single-legged execution that is deemed to be an obvious error under the Current Rule is nullified whenever a Customer is involved in the transaction, the Exchange believes adjusting execution prices is generally better for the marketplace than nullifying executions because liquidity providers often execute hedging transactions to offset options positions. When an options transaction is nullified the hedging

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<sup>14</sup> Only the execution price on the leg (or legs) that qualifies as an obvious or catastrophic error pursuant to any portion of Proposed Interpretation and Policy .04 will be adjusted. The execution price of a leg (or legs) that does not qualify as an obvious or catastrophic error will not be adjusted.

<sup>15</sup> See Rule 20.6(b) (defining the manner in which Theoretical Price is determined).

<sup>16</sup> See Rule 20.6(a)(1) (defining Customer for purposes of Rule 20.6 as not including a broker-dealer or Professional).

position can adversely affect the liquidity provider. With regards to complex orders that execute against individual legs, the additional rationale for adjusting erroneous execution prices when possible is the fact that the counterparty on a leg that is not executed at an obvious or catastrophic error price cannot look at the execution price to determine whether the execution may later be nullified (as opposed to the counterparty on single-legged order that is executed at an obvious error or catastrophic error price).

Paragraph (c)(4)(A) of the Current Rule mandates that if it is determined that an obvious error has occurred, the execution price of the transaction will be adjusted pursuant to the table set forth in (c)(4)(A). Although for simple orders paragraph (c)(4)(A) is only applicable when no party to the transaction is a Customer, for the purposes of complex orders paragraph (a) of Interpretation and Policy .04 will supersede that limitation; therefore, if it is determined that a leg (or legs) of a complex order is an obvious error, the leg (or legs) will be adjusted pursuant to (c)(4)(A), regardless of whether a party to the transaction is a Customer. The Size Adjustment Modifier defined in subparagraph (a)(4) will similarly apply (regardless of whether a Customer is on the transaction) by virtue of the application of paragraph (c)(4)(A).<sup>17</sup> The Exchange notes that adjusting all market participants is not unique or novel. When the Exchange determines that a simple order execution is a Catastrophic Error pursuant to the Current Rule, paragraph (d)(3) already provides for adjusting the execution price for all market participants, including Customers.

Furthermore, as with the Current Rule, Proposed Interpretation and Policy .04(a) provides protection for Customer orders, stating that where at least one party to a complex order

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<sup>17</sup> See Rule 20.6(c)(4)(A) (stating that any non-Customer Obvious Error exceeding 50 contracts will be subject to the Size Adjustment Modifier defined in sub-paragraph (a)(4)).

transaction is a Customer, the transaction will be nullified if adjustment would result in an execution price higher (for buy transactions) or lower (for sell transactions) than the Customer's limit price on the complex order or individual leg(s). For example, assume Customer enters a complex order to buy leg 1 and leg 2.

- Assume the NBBO for leg 1 is \$0.20-1.00 and the NBBO for leg 2 is \$0.50-1.00 and that these have been the NBBOs since the market opened.
- A split-second prior to the execution of the complex order a Customer enters a simple order to sell the leg 1 options series at \$1.30, and the simple order enters the Exchange's book so that the BBO is \$.20-\$1.30. The limit price on the simple order is \$1.30.
- The complex order executes leg 1 against the Exchange's best offer of \$1.30 and leg 2 at \$1.00 for a net execution price of \$2.30.
- However, leg 1 executed on a wide quote (the NBBO for leg 1 was \$0.20-1.00 at the time of execution, which is wider than \$0.75).<sup>18</sup> Leg 2 was not executed on a wide quote (the market for leg 2 was \$0.50-1.00); thus, leg 2 execution price stands.
- The Exchange determines that the Theoretical Price for leg 1 is \$1.00, which was the best offer prior to the execution. Leg 1 qualifies as an obvious error because the difference between the Theoretical Price (\$1.00) and the execution price (\$1.30) is larger than \$0.25.<sup>19</sup>
- According to Proposed Interpretation and Policy .04(a) Customers will also be adjusted in accordance with Rule 20.6(c)(4)(A), which for a buy transaction under

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<sup>18</sup> See Rule 20.6(b)(3).

<sup>19</sup> See Rule 20.6(c)(1).

\$3.00 calls for the Theoretical Price to be adjusted by adding \$0.15<sup>20</sup> to the Theoretical Price of \$1.00. Thus, adjust execution price for leg 1 would be \$1.15.

- However, adjusting the execution price of leg 1 to \$1.15 violates the limit price of the Customer's sell order on the simple order book for leg 1, which was \$1.30.
- Thus, the entire complex order transaction will be nullified<sup>21</sup> because the limit price of a Customer's sell order would be violated by the adjustment.<sup>22</sup>

As the above example demonstrates, incoming complex orders may execute against resting simple orders in the leg market. If a complex order leg is deemed to be an obvious error, adjusting the execution price of the leg may violate the limit price of the resting order, which will result in nullification if the resting order is for a Customer. In contrast, Interpretation and Policy .02 to Rule 20.6 provides that if an adjustment would result in an execution price that is higher than an erroneous buy transaction or lower than an erroneous sell transaction the execution will not be adjusted or nullified.<sup>23</sup> If the adjustment of a complex order would violate the complex order Customer's limit price, the transaction will be nullified.

As previously noted, paragraph (d)(3) of the Current Rule already mandates that if it is determined that a catastrophic error has occurred, the execution price of the transaction will be adjusted pursuant to the table set forth in (d)(3). For purposes of complex orders under Proposed Interpretation and Policy .04(a), if one of the legs of a complex orders is determined to be a Catastrophic Error under paragraph (d)(3), all market participants will be adjusted in accordance

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<sup>20</sup> See Rule 20.6(c)(4)(A).

<sup>21</sup> If any leg of a complex order is nullified, the entire transaction is nullified. See Proposed Interpretation and Policy .04(a).

<sup>22</sup> The simple order in this example is not an erroneous sell transaction because the execution price was not erroneously low. See Rule 20.6(a)(2).

<sup>23</sup> See Interpretation and Policy .02 to Rule 20.6.

with the table set forth in (d)(3). Again, however, where at least one party to a complex order transaction is a Customer, the transaction will be nullified if adjustment would result in an execution price higher (for buy transactions) or lower (for sell transactions) than the Customer's limit price on the complex order or individual leg(s). Again, if any leg of a complex order is nullified, the entire transaction is nullified.

Other than honoring the limit prices established for Customer orders, the Exchange has proposed to treat Customers and non-Customers the same in the context of the complex orders that trade against the leg market. When complex orders trade against the leg market, it is possible that at least some of the legs will execute at prices that would not be deemed obvious or catastrophic errors, which gives the counterparty in such situations no indication that the execution will later be adjusted or nullified. The Exchange believes that treating Customers and non-Customers the same in this context will provide additional certainty to non-Customers (especially Market-Makers) with respect to their potential exposure and hedging activities, including comfort that even if a transaction is later adjusted, such transaction will not be fully nullified. However, as noted above, under the Proposed Rule where at least one party to the transaction is a Customer, the trade will be nullified if the adjustment would result in an execution price higher (for buy transactions) or lower (for sell transactions) than the Customer's limit price on the complex order or individual leg(s). The Exchange has retained the protection of a Customer's limit price in order to avoid a situation where the adjustment could be to a price that a Customer would not have expected, and market professionals such as non-Customers would be better prepared to recover in such situations. Therefore, adjustment for non-Customers is more appropriate.

Second, proposed Interpretation and Policy .04(b) governs the review of complex orders

that are executed against other complex orders. Proposed Interpretation and Policy .04(b) provides:

If a complex order executes against another complex order and at least one of the legs qualifies as an Obvious Error under paragraph (c)(1) or a Catastrophic Error under paragraph (d)(1), then the leg(s) that is an Obvious or Catastrophic Error will be adjusted or busted in accordance with paragraph (c)(4) or (d)(3), respectively, so long as either: (i) the width of the National Spread Market for the complex order strategy just prior to the erroneous transaction was equal to or greater than the amount set forth in the wide quote table of paragraph (b)(3) or (ii) the net execution price of the complex order is higher (lower) than the offer (bid) of the National Spread Market for the complex order strategy just prior to the erroneous transaction by an amount equal to at least the amount shown in the table in paragraph (c)(1). If any leg of a complex order is nullified, the entire transaction is nullified. For purposes of Rule 20.6, the National Spread Market for a complex order strategy is determined by the National Best Bid/Offer of the individual legs of the strategy (i.e., the SNBBO under Rule 21.20).

As described above in relation to Proposed Interpretation and Policy .04(a), the first step is for the Exchange to review (upon receipt of a timely notification in accordance with paragraphs (c)(2) or (d)(2) of the Current Rule) the individual legs to determine whether a leg or legs qualifies as an obvious or catastrophic error. If no leg qualifies as an obvious or catastrophic error, the transaction stands—no adjustment and no nullification.

Unlike Proposed Interpretation and Policy .04(a), the Exchange is also proposing to compare the net execution price of the entire complex order package to the National Spread Market (“NSM”) for the complex order strategy.<sup>24</sup> Complex orders are exempt from the order protection rules of the options exchanges.<sup>25</sup> Thus, depending on the manner in which the systems of an options exchange are calibrated, a complex order can execute without regard to the

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<sup>24</sup> The NSM is the derived net market for a complex order package and is equivalent to the term SNBBO in Exchange Rule 21.20(a)(12). For example, if the NBBO of Leg 1 is \$1.00-2.00 and the NBBO of Leg 2 is \$5.00-7.00, then the NSM for a complex order to buy Leg 1 and buy Leg 2 is \$6.00-9.00. The Exchange has proposed to retain the term NSM to retain consistency with other options exchanges that have already adopted uniform rules related to complex orders.

<sup>25</sup> See Rule 27.2(a)(8). All options exchanges have the same order protection rule.

prices offered in the complex order books or the leg markets of other options exchanges. In certain situations, reviewing the execution prices of the legs in a vacuum would make the leg appear to be an obvious or catastrophic error, even though the net execution price on the complex order is not an erroneous price. For example, assume the Exchange receives a complex order to buy ABC calls and sell ABC puts.

- If the BBO for the ABC calls is \$5.50-7.50 and the BBO for ABC puts is \$3.00-4.50, then the Exchange's spread market is \$1.00-4.50.<sup>26</sup>
- If the NBBO for the ABC calls is \$6.00-6.50 and the NBBO for the ABC puts is \$3.50-4.00, then the NSM is \$2.00-3.00.
- If the Customer buys the calls at \$7.50 and sells the puts at \$4.00, the complex order Customer receives a net execution price of \$3.00 (debit), which is the expected net execution price as indicated by the NSM offer of \$3.00.

If the Exchange were to solely focus on the \$7.50 execution price of the ABC calls or the \$4.00 execution price of the ABC puts, the execution would qualify as an obvious or catastrophic error because the execution price on the legs was outside the NBBO, even though the net execution price is accurate. Thus, the additional review of the NSM to determine if the complex order was executed at a truly erroneous price is necessary. The same concern is not present when a complex order executes against the leg market under proposed Interpretation and Policy .04(a). The Exchange permits a given leg of a complex order to trade through the NBBO

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<sup>26</sup> The complex order is to buy ABC calls and sell ABC puts. The Exchange's best offer for ABC puts is \$7.50 and Exchange's best bid for is \$3.00. If the Customer were to buy the complex order strategy, the Customer would receive a debit of \$4.50 (buy ABC calls for \$7.50 minus selling ABC puts for \$3.00). If the Customer were to sell the complex order strategy the Customer would receive a credit of \$1.00 (selling the ABC calls for \$5.50 minus buying the ABC puts for \$4.50). Thus, the Exchange's spread market is \$1.00-4.50.

provided the complex order trades no more than a configurable amount outside of the NBBO.<sup>27</sup>

In order to incorporate NSM, proposed Interpretation and Policy .04(b) provides that if the Exchange determines that a leg or legs does qualify as an obvious or catastrophic error, the leg or legs will be adjusted or busted in accordance with paragraph (c)(4) or (d)(3) of the Current Rule, so long as either: (i) the width of the NSM for the complex order strategy just prior to the erroneous transaction was equal to or greater than the amount set forth in the wide quote table of paragraph (b)(3) of the Current Rule or (ii) the net execution price of the complex order is higher (lower) than the offer (bid) of the NSM for the complex order strategy just prior to the erroneous transaction by an amount equal to at least the amount shown in the table in paragraph (c)(1) of the Current Rule.

For example, assume an individual leg or legs qualifies as an obvious or catastrophic error and the width of the NSM of the complex order strategy just prior to the erroneous transaction is \$6.00-9.00. The complex order will qualify to be adjusted or busted in accordance with paragraph (c)(4) of the Current Rule because the wide quote table of paragraph (b)(3) of the Current Rule indicates that the minimum amount is \$1.50 for a bid price between \$5.00 to \$10.00. If the NSM were instead \$6.00-7.00 the complex order strategy would not qualify to be adjusted or busted pursuant to proposed Interpretation and Policy .04(b)(i) because the width of the NSM is \$1.00, which is less than the required \$1.50. However, the execution may still

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<sup>27</sup> See Rule 20.20 [sic], Interpretation and Policy .04(f), which states: “The Drill-Through Price Protection feature is a price protection mechanism applicable to all complex orders under which a buy (sell) order will not be executed at a price that is higher (lower) than the SNBBO or the SNBBO at the time of order entry plus (minus) a buffer amount (the “Drill-Through Price”). The Exchange will adopt a default buffer amount for the Drill-Through Price Protection and will publish this amount in publicly available specifications and/or a Regulatory Circular. A Member may modify the buffer amount applicable to Drill-Through Price Protections to either a larger or smaller amount than the Exchange default....”

qualify to be adjusted or busted in accordance with paragraph (c)(4) or (d)(3) of the Current Rule pursuant to proposed Interpretation and Policy .04(b)(ii). Focusing on the NSM in this manner will ensure that the obvious/catastrophic error review process focuses on the net execution price instead of the execution prices of the individual legs, which may have execution prices outside of the NBBO of the leg markets.

Again, assume an individual leg or legs qualifies as an obvious or catastrophic error as described above. If the NSM is \$6.00-7.00 (not a wide quote pursuant to the wide quote table in paragraph (b)(3) of the Current Rule) but the execution price of the entire complex order package (i.e., the net execution price) is higher (lower) than the offer (bid) of the NSM for the complex order strategy just prior to the erroneous transaction by an amount equal to at least the amount in the table in paragraph (c)(1) of the Current Rule, then the complex order qualifies to be adjusted or busted in accordance with paragraph (c)(4) or (d)(3) of the Current Rule. For example, if the NSM for the complex order strategy just prior to the erroneous transaction is \$6.00-7.00 and the net execution price of the complex order transaction is \$7.75, the complex order qualifies to be adjusted or busted in accordance with paragraph (c)(4) of the Current Rule because the execution price of \$7.75 is more than \$0.50 (i.e., the minimum amount according to the table in paragraph (c)(1) when the price is above \$5.00 but less than \$10.01) from the NSM offer of \$7.00.

Focusing on the NSM in this manner will ensure that the obvious/catastrophic error review process focuses on the net execution price instead of the execution prices of the individual legs, which may have execution prices outside of the NBBO of the leg markets.

Although the Exchange believes adjusting execution prices is generally better for the marketplace than nullifying executions because liquidity providers often execute hedging transactions to offset options positions, the Exchange recognizes that complex orders executing

against other complex orders is similar to simple orders executing against other simple orders because both parties are able to review the execution price to determine whether the transaction may have been executed at an erroneous price. Thus, for purposes of complex orders that meet the requirements of Interpretation and Policy .04(b), the Exchange proposes to apply the Current Rule and adjust or bust obvious errors in accordance with paragraph (c)(4) (as opposed to applying paragraph (c)(4)(A) as is the case under proposed Interpretation and Policy .04(a)) and catastrophic errors in accordance with (d)(3).

Therefore, for purposes of complex orders under Proposed Interpretation and Policy .04(b), if one of the legs is determined to be an obvious error under paragraph (c)(1), all Customer transactions will be nullified, unless a Member submits 200 or more Customer transactions for review in accordance with (c)(4)(C) of the Current Rule.<sup>28</sup> For purposes of complex orders under Interpretation and Policy .04(b), if one of the legs is determined to be a catastrophic error under paragraph (d)(3) and all of the other requirements of Interpretation and Policy .04(b) are met, all market participants will be adjusted in accordance with the table set forth in (d)(3) of the Current Rule. Again, however, pursuant to paragraph (d)(3) where at least one party to a complex order transaction is a Customer, the transaction will be nullified if adjustment would result in an execution price higher (for buy transactions) or lower (for sell transactions) than the Customer's limit price on the complex order or individual leg(s). Also, if any leg of a complex order is nullified, the entire transaction is nullified.

### ***Implementation Date***

The Exchange anticipates launching its complex order book on October 23, 2017. Accordingly, the Exchange proposes to implement this rule immediately.

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<sup>28</sup> Rule 20.6(c)(4)(C) also requires the orders resulting in 200 or more Customer transactions to have been submitted during the course of 2 minutes or less.

## 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>29</sup> Specifically, the proposal is consistent with Section 6(b)(5) of the Act<sup>30</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.

As described above, the Exchange and other options exchanges are seeking to adopt harmonized rules related to the adjustment and nullification of erroneous options transactions. The Exchange believes that the Proposed Rule will provide greater transparency and clarity with respect to the adjustment and nullification of erroneous options transactions. Particularly, the proposed changes seek to achieve consistent results for participants across U.S. options exchanges while maintaining a fair and orderly market, protecting investors and protecting the public interest. Based on the foregoing, the Exchange believes that the proposal is consistent with Section 6(b)(5) of the Act<sup>31</sup> in that the Proposed Rule will foster cooperation and coordination with persons engaged in regulating and facilitating transactions.

The Exchange believes the various provisions allowing or dictating adjustment rather than nullification of a trade are necessary given the benefits of adjusting a trade price rather than nullifying the trade completely. Because options trades are used to hedge, or are hedged by, transactions in other markets, including securities and futures, many Members, and their customers, would rather adjust prices of executions rather than nullify the transactions and, thus,

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<sup>29</sup> 15 U.S.C. 78f(b).

<sup>30</sup> 15 U.S.C. 78f(b)(5).

<sup>31</sup> 15 U.S.C. 78f(b)(5).

lose a hedge altogether. As such, the Exchange believes it is in the best interest of investors to allow for price adjustments as well as nullifications.

The Exchange does not believe that the proposal is unfairly discriminatory, even though it differentiates in many places between Customers and non-Customers. As with the Current Rule, Customers are treated differently, often affording them preferential treatment. This treatment is appropriate in light of the fact that Customers are not necessarily immersed in the day-to-day trading of the markets, are less likely to be watching trading activity in a particular option throughout the day, and may have limited funds in their trading accounts. At the same time, the Exchange reiterates that in the U.S. options markets generally there is significant retail customer participation that occurs directly on (and only on) options exchanges such as the Exchange. Accordingly, differentiating among market participants with respect to the adjustment and nullification of erroneous options transactions is not unfairly discriminatory because it is reasonable and fair to provide Customers with additional protections as compared to non-Customers.

The Exchange believes that its proposal to adopt the ability to adjust a Customer's execution price when a complex order is deemed to be an Obvious or Catastrophic Error is consistent with the Act. A complex order that executes against individual leg markets may receive an execution price on an individual leg that is not an Obvious or Catastrophic error but another leg of the transaction is an Obvious or Catastrophic Error. In such situations where the complex order is executing against at least one individual or firm that is not aware of the fact that they have executed against a complex order or that the complex order has been executed at an erroneous price, the Exchange believes it is more appropriate to adjust execution prices if possible because the derivative transactions are often hedged with other securities. Allowing

adjustments instead of nullifying transactions in these limited situations will help to ensure that market participants are not left with a hedge that has no position to hedge against.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. Importantly, the Exchange believes the proposal will not impose a burden on intermarket competition but will rather alleviate any burden on competition because it is the result of a collaborative effort by all options exchanges to harmonize and improve the process related to the adjustment and nullification of erroneous options transactions. The Exchange does not believe that the rules applicable to such process is an area where options exchanges should compete, but rather, that all options exchanges should have consistent rules to the extent possible. Particularly where a market participant trades on several different exchanges and an erroneous trade may occur on multiple markets nearly simultaneously, the Exchange believes that a participant should have a consistent experience with respect to the nullification or adjustment of transactions. The Exchange understands that all other options exchanges that trade complex orders and/or stock-option orders have adopted rules that are substantially similar to this proposal.

The Exchange does not believe that the proposed rule change imposes a burden on intramarket competition because the provisions apply to all market participants equally within each participant category (i.e., Customers and non-Customers). With respect to competition between Customer and non-Customer market participants, the Exchange believes that the Proposed Rule acknowledges competing concerns and tries to strike the appropriate balance between such concerns. For instance, the Exchange believes that protection of Customers is important due to their direct participation in the options markets as well as the fact that they are

not, by definition, market professionals. At the same time, the Exchange believes due to the quote-driven nature of the options markets, the importance of liquidity provision in such markets and the risk that liquidity providers bear when quoting a large breadth of products that are derivative of underlying securities, that the protection of liquidity providers and the practice of adjusting transactions rather than nullifying them is of critical importance. As described above, the Exchange will apply specific and objective criteria to determine whether an erroneous transaction has occurred and, if so, how to adjust or nullify a transaction.

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 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>32</sup> and Rule 19b-4(f)(6) thereunder.<sup>33</sup>

A proposed rule change filed pursuant to Rule 19b-4(f)(6) under the Act<sup>34</sup> normally does

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<sup>32</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>33</sup> 17 CFR 240.19b-4(f)(6). As required under Rule 19b-4(f)(6)(iii), the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and the text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

<sup>34</sup> 17 CFR 240.19b-4(f)(6).

not become operative for 30 days after the date of its filing. However, Rule 19b-4(f)(6)(iii)<sup>35</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the Exchange may, as soon as possible, implement the changes proposed by this filing. The Exchange notes that the proposal will promote consistency between the Exchange and other options exchanges that accept complex orders. For this reason, the Commission believes the waiver of the operative delay is consistent with the protection of investors and the public interest. Accordingly, the Commission hereby waives the operative delay and designates the proposed rule change operative upon filing.<sup>36</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. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or 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 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

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<sup>35</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>36</sup> For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-BatsEDGX-2017-43 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-BatsEDGX-2017-43. 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, D.C. 20549 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 office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to File Number SR-BatsEDGX-2017-43, 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>37</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>37</sup> 17 CFR 200.30-3(a)(12).