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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74556; File No. SR-BATS-2014-067)

Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing of Amendment No. 2, and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2 Thereto, to BATS Rules 20.3 and 20.6

March 20, 2015

I. Introduction

On December 4, 2014, BATS Exchange, Inc. (the “Exchange” or “BATS”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to Exchange Rule 20.6 (relating to the adjustment and nullification of transactions that occur on the Exchange’s equity options platform) and Exchange Rule 20.3 (relating to trading halts). On December 17, 2014, the Exchange submitted Amendment No. 1 to the proposed rule change, which amended and replaced the proposed rule change in its entirety. The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on December 24, 2014.³ The Commission received two comment letters on the proposed rule change.⁴ On March 4, 2015, the Exchange submitted a response to the comment letters.⁵ On

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 73884 (December 18, 2014), 79 FR 77557 (“Notice”).

⁴ See letters to Brent J. Fields, Secretary, Commission, from Paul M. Russo, Managing Director, Goldman Sachs & Co., dated January 13, 2015 (“Goldman Letter”); and Ellen Greene, Managing Director, Securities Industry and Financial Markets Association, dated January 28, 2015 (“SIFMA Letter”).

March 13, 2015, the Exchange submitted Amendment No. 2 to the proposed rule change.⁶ The Commission is publishing this notice to solicit comment on Amendment No. 2 to the proposed rule change from interested persons and is approving the proposed rule change, as modified by Amendment Nos. 1 and 2, on an accelerated basis.

II. Description of the Proposed Rule Change

The Exchange proposes to replace current Exchange Rule 20.6 (“Current Rule”), entitled “Obvious Error,” with new Exchange Rule 20.6 (“Proposed Rule”), entitled “Nullification and Adjustment of Options Transactions including Obvious Errors.” Exchange Rule 20.6 relates to the adjustment and nullification of transactions that occur on the Exchange’s equity options platform (“BATS Options”).

A. Background

The Exchange has been working with other options exchanges to identify ways to improve the process related to the adjustment and nullification of erroneous options transactions. The Proposed Rule is the culmination of a coordinated effort by the options exchanges to address the August 22, 2013, halt of trading in Nasdaq-listed securities (“Nasdaq SIP Failure”).

⁵ See letter to Brent J. Fields, Secretary, Commission, from Anders W. Franzon, Vice President and Associate General Counsel, BATS Exchange, Inc., dated March 4, 2015 (“BATS Response Letter”).

⁶ In Amendment No. 2, the Exchange: (1) made technical, non-substantive corrections to the definition of “Size Adjustment Modifier” in paragraph (a)(4) of Proposed Rule 20.6 and the criterion used to measure the occurrence of a Significant Market Event in paragraph (e)(1) of Proposed Rule 20.6; (2) amended the description in paragraph (b) of Proposed Rule 20.6 to use the last NBB and last NBO prior to the Exchange’s receipt of an order as the Theoretical Price for determining the execution price at all price levels when a single order is executed at multiple price levels; (3) updated the expiration date of the pilot program related to the suspension of certain provisions of the Proposed Rule to October 23, 2015 in connection with the Limit Up-Limit Down Plan and made clear that it would provide a publicly available assessment of the operation of this portion of the Proposed Rule by May 29, 2015; and (4) proposed an implementation date of May 8, 2015, to allow all the other options exchanges the time necessary to harmonize their obvious error rules with the Proposed Rule.

Following the Nasdaq SIP Failure, the Chair of the Commission met with the heads of the securities exchanges to discuss potential initiatives aimed at addressing market resilience.⁷ The Proposed Rule responds to the Chair’s initiative, and reflects discussions by the options exchanges to universally adopt: (1) certain provisions already in place on one or more options exchanges; and (2) new provisions that the options exchanges collectively believe will improve the handling of erroneous options transactions.

B. Proposed Rule

1. Definitions

The Exchange proposes to adopt various definitions that will be used in the Proposed Rule, as described below.

First, the Exchange proposes to adopt a definition of “Customer,” to make clear that this term would not include any broker-dealer or Professional Customer.⁸

Second, the Exchange proposes to adopt definitions for both an “erroneous sell transaction” and an “erroneous buy transaction.” As proposed, an erroneous sell transaction is one in which the price received by the person selling the option is erroneously low, and an erroneous buy transaction is one in which the price paid by the person purchasing the option is erroneously high.

Third, the Exchange proposes to adopt a definition of “Official,” which would mean an Officer of the Exchange or such other employee designee of the Exchange that is trained in the application of the Proposed Rule.

⁷ See SEC Press Release No. 2013-178 (September 12, 2013), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539804861>.

⁸ A “Professional” is any person or entity that (A) is not a broker or dealer in securities; and (B) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). See Exchange Rule 16.1(a)(45).

Fourth, the Exchange proposes to adopt a new term, a “Size Adjustment Modifier,” which would apply to individual transactions and would modify the applicable adjustment for transactions under certain circumstances, as discussed in further detail below. As proposed, the Size Adjustment Modifier will be applied to individual transactions as follows:

Number of Contracts per Execution	Adjustment: Theoretical Price (as defined below) Plus/Minus
1-50	N/A
51-250	2 times adjustment amount
251-1000	2.5 times adjustment amount
1001 or more	3 times adjustment amount

2. Calculation of Theoretical Price

a. Theoretical Price in Normal Circumstances

When reviewing a transaction as potentially erroneous, the Exchange needs to first determine the “Theoretical Price” of the option, i.e., the Exchange’s estimate of the correct market price for the option. Pursuant to the Proposed Rule, if the applicable option series is traded on at least one other options exchange, then the Theoretical Price of an option series is the last national best bid (“NBB”) just prior to the trade in question with respect to an erroneous sell transaction or the last national best offer (“NBO”) just prior to the trade in question with respect to an erroneous buy transaction unless one of the exceptions described below exists. Thus, the Exchange proposes that whenever the Exchange has a reliable NBB or NBO, as applicable, just prior to the transaction, then the Exchange will use this NBB or NBO as the Theoretical Price.

The Exchange also proposes to specify in the Proposed Rule that when a single order received by the Exchange is executed at multiple price levels, the Exchange would use the last NBB and last NBO just prior to the Exchange’s receipt of the order as the Theoretical Price for determining the execution price at all price levels.

The Exchange also proposes to set forth in the Proposed Rule various provisions

governing specific situations where the NBB or NBO is not available or may not be reliable. Specifically, the Exchange is proposing additional detail specifying situations in which there are no quotes or no valid quotes (as defined below), when the national best bid or offer (“NBBO”) is determined to be too wide to be reliable, and at the open of trading on each trading day.

b. No Valid Quotes

The Exchange proposes to determine the Theoretical Price if there are no quotes or no valid quotes for comparison purposes. As proposed, quotes that are not valid are all quotes in the applicable option series published at a time where the last NBB is higher than the last NBO in such series (a “crossed market”), quotes published by the Exchange that were submitted by either party to the transaction in question, and quotes published by another options exchange against which the Exchange has declared self-help. Thus, in addition to scenarios where there are literally no quotes to be used as Theoretical Price, the Exchange will exclude quotes in certain circumstances if such quotes are not deemed valid.

c. Wide Quotes

The Exchange proposes to determine the Theoretical Price if the bid/ask differential of the NBB and NBO for the affected series just prior to the erroneous transaction was equal to or greater than the Minimum Amount set forth below and there was a bid/ask differential less than the Minimum Amount during the 10 seconds prior to the transaction. If there was no bid/ask differential less than the Minimum Amount during the 10 seconds prior to the transaction then the Theoretical Price of an option series is the last NBB or NBO just prior to the transaction in question. The Exchange proposes to use the following chart (“Wide Quote Chart”) to determine whether a quote is too wide to be reliable:

Bid Price at Time of Trade	Minimum Amount
Below \$2.00	\$0.75

\$2.00 to \$5.00	\$1.25
Above \$5.00 to \$10.00	\$1.50
Above \$10.00 to \$20.00	\$2.50
Above \$20.00 to \$50.00	\$3.00
Above \$50.00 to \$100.00	\$4.50
Above \$100.00	\$6.00

As described above, while the Exchange proposes to determine Theoretical Price when the bid/ask differential equals or exceeds the amount set forth in the chart above and within the previous 10 seconds there was a bid/ask differential smaller than such amount, if a quote has been persistently wide for at least 10 seconds the Exchange will use such quote for purposes of Theoretical Price.

d. Transactions at the Open

The Exchanges proposes that, for a transaction occurring as part of the Opening Process,⁹ the Exchange will determine the Theoretical Price where there is no NBB or NBO for the affected series just prior to the erroneous transaction or if the bid/ask differential of the NBBO just prior to the erroneous transaction is equal to or greater than the Minimum Amount set forth in the Wide Quote Chart. If, however, there are valid quotes and the bid/ask differential of the NBBO is less than the Minimum Amount set forth in the Wide Quote Chart, then the Exchange proposes to use the NBB or NBO just prior to the transaction as it would in any other normal review scenario.

3. Obvious Errors

The Exchange proposes to adopt numerical thresholds similar to those in place under the Current Rule that would qualify transactions as “Obvious Errors.” As proposed, a transaction will qualify as an Obvious Error if the Exchange receives a properly submitted filing and the execution price of a transaction is higher or lower than the Theoretical Price for the series by an

⁹ See Exchange Rule 21.7 for a description of the Exchange’s Opening Process.

amount equal to at least the amount shown below:

Theoretical Price	Minimum Amount
Below \$2.00	\$0.25
\$2.00 to \$5.00	\$0.40
Above \$5.00 to \$10.00	\$0.50
Above \$10.00 to \$20.00	\$0.80
Above \$20.00 to \$50.00	\$1.00
Above \$50.00 to \$100.00	\$1.50
Above \$100.00	\$2.00

Under the Proposed Rule, a party that believes that it participated in a transaction that was the result of an Obvious Error must notify the Exchange's Trade Desk in the manner specified from time to time by the Exchange in a circular distributed to Members.

The Exchange also proposes to adopt notification timeframes that must be met in order for a transaction to qualify as an Obvious Error. Specifically, as proposed, a filing must be received by the Exchange within 30 minutes of the execution with respect to an execution of a Customer order and within 15 minutes of the execution for any other participant. The Exchange also proposes to provide additional time for trades that are routed through other options exchanges to the Exchange. Under the Proposed Rule, any other options exchange will have a total of 45 minutes for Customer orders and 30 minutes for non-Customer orders, measured from the time of execution on the Exchange, to file with the Exchange for review of transactions routed to the Exchange from that options exchange and executed on the Exchange ("linkage trades"). This includes filings on behalf of another options exchange filed by a third-party routing broker if such third-party broker identifies the affected transactions as linkage trades. In order to facilitate timely reviews of linkage trades, the Exchange will accept filings from either the other options exchange or, if applicable, the third-party routing broker that routed the applicable order(s). The additional 15 minutes provided with respect to linkage trades shall only apply to the extent the options exchange that originally received and routed the order to the

Exchange itself received a timely filing from the entering participant (i.e., within 30 minutes if a Customer order or 15 minutes if a non-Customer order).

Pursuant to the Proposed Rule, an Official may review a transaction believed to be erroneous on his/her own motion in the interest of maintaining a fair and orderly market and for the protection of investors. A transaction reviewed pursuant to the proposed provision may be nullified or adjusted only if it is determined by the Official that the transaction is erroneous in accordance with the provisions of the Proposed Rule, provided that the time deadlines for filing a request for review described above shall not apply. The Proposed Rule would require the Official to act as soon as possible after becoming aware of the transaction; action by the Official would ordinarily be expected on the same day that the transaction occurred. However, because a transaction under review may have occurred near the close of trading or due to unusual circumstances, the Proposed Rule provides that the Official shall act no later than 8:30 a.m. Eastern Time on the next trading day following the date of the transaction in question.

The Exchange also proposes to state that a party affected by a determination to nullify or adjust a transaction after an Official's review on his or her own motion may appeal such determination, as described below. The Proposed Rule would make clear that a determination by an Official not to review a transaction or determination not to nullify or adjust a transaction for which a review was conducted on an Official's own motion is not appealable and further that if a transaction is reviewed and a determination is rendered pursuant to another provision of the Proposed Rule, no additional relief may be granted by an Official.

If it is determined that an Obvious Error has occurred based on the objective numeric criteria and time deadlines described above, the Exchange will adjust or nullify the transaction as described below and promptly notify both parties to the trade electronically or via telephone.

The Exchange proposes different adjustment and nullification criteria for Customers and non-Customers.

As proposed, where neither party to the transaction is a Customer, the execution price of the transaction will be adjusted by the Official pursuant to the table below.

Theoretical Price (TP)	Buy Transaction Adjustment: TP Plus	Sell Transaction Adjustment: TP Minus
Below \$3.00	\$0.15	\$0.15
At or above \$3.00	\$0.30	\$0.30

Further, as proposed, any non-Customer Obvious Error exceeding 50 contracts will be subject to the Size Adjustment Modifier described above.

In contrast to non-Customer orders, where trades will be adjusted if they qualify as Obvious Errors, pursuant the Proposed Rule, a trade that qualifies as an Obvious Error will be nullified where at least one party to the Obvious Error is a Customer. The Exchange also proposes, however, that if any Member submits requests to the Exchange for review of transactions pursuant to the Proposed Rule, and in aggregate that Member has 200 or more Customer transactions under review concurrently and the orders resulting in such transactions were submitted during the course of 2 minutes or less, where at least one party to the Obvious Error is a non-Customer, the Exchange will apply the non-Customer adjustment criteria described above to such transactions.

4. Catastrophic Errors

The Exchange further proposes to adopt separate numerical thresholds for review of transactions for which the Exchange does not receive a filing requesting review within the Obvious Error timeframes set forth above. Based on this review, these transactions may qualify as “Catastrophic Errors.” As proposed, a Catastrophic Error will be deemed to have occurred

when the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount equal to at least the amount shown below:

Theoretical Price	Minimum Amount
Below \$2.00	\$0.50
\$2.00 to \$5.00	\$1.00
Above \$5.00 to \$10.00	\$1.50
Above \$10.00 to \$20.00	\$2.00
Above \$20.00 to \$50.00	\$2.50
Above \$50.00 to \$100.00	\$3.00
Above \$100.00	\$4.00

Under the Proposed Rule, parties have additional time to submit transactions for review as Catastrophic Errors. As proposed, notification requesting review must be received by the Exchange's Trade Desk by 8:30 a.m. Eastern Time on the first trading day following the execution. For transactions in an expiring options series that take place on an expiration day, a party must notify the Exchange's Trade Desk within 45 minutes after the close of trading that same day. As is true for requests for review under the Obvious Error provision of the Proposed Rule, a party requesting review of a transaction as a Catastrophic Error must notify the Exchange's Trade Desk in the manner specified from time to time by the Exchange in a circular distributed to Members. By definition, any execution that qualifies as a Catastrophic Error is also an Obvious Error.

The Proposed Rule would specify the action to be taken by the Exchange if it is determined that a Catastrophic Error has occurred, as described above, and would require the Exchange to promptly notify both parties to the trade electronically or via telephone. In the event of a Catastrophic Error, the execution price of the transaction will be adjusted by the Official pursuant to the table below.

Theoretical Price (TP)	Buy Transaction Adjustment: TP Plus	Sell Transaction Adjustment: TP Minus
Below \$2.00	\$0.50	\$0.50

\$2.00 to \$5.00	\$1.00	\$1.00
Above \$5.00 to \$10.00	\$1.50	\$1.50
Above \$10.00 to \$20.00	\$2.00	\$2.00
Above \$20.00 to \$50.00	\$2.50	\$2.50
Above \$50.00 to \$100.00	\$3.00	\$3.00
Above \$100.00	\$4.00	\$4.00

Although Customer orders would be adjusted in the same manner as non-Customer orders, any Customer order that qualifies as a Catastrophic Error 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.

5. Significant Market Events

Furthermore, the Exchange proposes to adopt a new provision that calls for coordination between the options exchanges in certain circumstances and provides limited flexibility in the application of other provisions of the Proposed Rule in order to promptly respond to a widespread market event.¹⁰ The Exchange proposes to describe such an event as a Significant Market Event ("SME"), and to set forth certain objective criteria that will determine whether such an event has occurred. The Exchange developed these objective criteria in consultation with the other options exchanges by reference to historical patterns and events with a goal of setting thresholds that very rarely will be triggered so as to limit the application of the provision to truly significant market events. As proposed, an SME will be deemed to have occurred when proposed criterion (A) below is met or exceeded or the sum of all applicable event statistics,

¹⁰ Although the Exchange has proposed a specific provision related to coordination amongst options exchanges in the context of a widespread event, the Exchange does not believe that the SME provision or any other provision of the proposed rule alters the Exchange's ability to coordinate with other options exchanges in the normal course of business with respect to market events or activity. The Exchange does already coordinate with other options exchanges to the extent possible if such coordination is necessary to maintain a fair and orderly market and/or to fulfill the Exchange's duties as a self-regulatory organization.

where each is expressed as a percentage of the relevant threshold in criteria (A) through (D) below, is greater than or equal to 150%, and at least one of the event statistics reaches 75% or more of the category, provided that no single category can contribute more than 100% to the sum of categories (A) through (D). All categories set forth below will be measured in aggregate across all exchanges. Any category satisfying more than 100% will be rounded down to 100%.

The proposed criteria for determining an SME are as follows:

(A) Transactions that are potentially erroneous would result in a total Worst-Case Adjustment Penalty of \$30,000,000, where the Worst-Case Adjustment Penalty is computed as the sum, across all potentially erroneous trades, of: (i) \$0.30 (i.e., the largest Transaction Adjustment value listed in sub-paragraph (e)(3)(A) below); times; (ii) the contract multiplier for each traded contract; times (iii) the number of contracts for each trade; times (iv) the appropriate Size Adjustment Modifier for each trade, if any, as defined in sub-paragraph (e)(3)(A) below;

(B) Transactions involving 500,000 options contracts are potentially erroneous;

(C) Transactions with a notional value (i.e., number of contracts traded multiplied by the option premium multiplied by the contract multiplier) of \$100,000,000 are potentially erroneous;

(D) 10,000 transactions are potentially erroneous.

As described above, the Exchange proposes to adopt the Worst Case Adjustment Penalty, proposed as criterion (A), which is the only criterion that can on its own result in an event being designated as a significant market event. If the Worst Case Adjustment criterion is equal to or exceeds \$30,000,000, then an event is an SME.

As described above, under the Proposed Rule, if the Worst Case Adjustment Penalty is less than \$30,000,000, then an SME has occurred if the sum of all applicable event statistics (expressed as a percentage of the relevant thresholds in criteria (A) through (D) above), is greater than or equal to 150% and 75% or more of at least one category is reached. The Proposed Rule further provides that no single category can contribute more than 100% to the sum and any category contributing more than 100% will be rounded down to 100%.

To ensure consistent application across options exchanges, in the event of a suspected SME, the Exchange shall initiate a coordinated review of potentially erroneous transactions with all other affected options exchanges to determine the full scope of the event. Under the Proposed Rule, the Exchange will promptly coordinate with the other options exchanges to determine the appropriate review period as well as select one or more specific points in time prior to the transactions in question and use one or more specific points in time to determine Theoretical Price. Other than the selected points in time, if applicable, the Exchange will determine Theoretical Price as described above.

If it is determined that an SME has occurred then, using the parameters agreed with respect to the times from which Theoretical Price will be calculated, if applicable, an Official will determine whether any or all transactions under review qualify as Obvious Errors. The Proposed Rule would require the Exchange to use the criteria for determining whether an Obvious Error has occurred, as described above, for each transaction that was part of the SME. Upon taking any final action, the Exchange would be required to promptly notify both parties to the trade electronically or via telephone.

The execution price of each affected transaction will be adjusted by an Official to the price provided below, unless both parties agree to adjust the transaction to a different price or

agree to bust the trade.

Theoretical Price (TP)	Buy Transaction Adjustment: TP Plus	Sell Transaction Adjustment: TP Minus
Below \$3.00	\$0.15	\$0.15
At or above \$3.00	\$0.30	\$0.30

Thus, the proposed adjustment criteria for SMEs are identical to the proposed adjustment levels for Obvious Errors generally. In addition, in the context of an SME, any error exceeding 50 contracts will be subject to the Size Adjustment Modifier described above. Also, the adjustment criteria would apply equally to all market participants (*i.e.*, Customers and non-Customers) in an SME. However, as is true for the proposal with respect to Catastrophic Errors, 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.

Another significant distinction between the proposed Obvious Error provision and the proposed SME provision is that if the Exchange, in consultation with other options exchanges, determines that timely adjustment is not feasible due to the extraordinary nature of the situation, then the Exchange will nullify some or all transactions arising out of the SME during the review period selected by the Exchange and other options exchanges. To the extent the Exchange, in consultation with other options exchanges, determines to nullify less than all transactions arising out of the SME, those transactions subject to nullification will be selected based upon objective criteria with a view toward maintaining a fair and orderly market and the protection of investors and the public interest. Furthermore, the Proposed Rule provides that rulings by the Exchange pursuant to the SME provision would be non-appealable.

6. Mutual Agreement

The Proposed Rule also proposes to make clear that the determination as to whether a trade was executed at an erroneous price may be made by mutual agreement of the affected parties to a particular transaction. The Proposed Rule provides that a trade may be nullified or adjusted on the terms that all parties to a particular transaction agree, provided, however, that such agreement to nullify or adjust must be conveyed to the Exchange in a manner prescribed by the Exchange prior to 8:30 a.m. Eastern Time on the first trading day following the execution. The Exchange also proposes to explicitly state that it is considered conduct inconsistent with just and equitable principles of trade for any Member to use the mutual adjustment process to circumvent any applicable Exchange rule, the Act or any of the rules and regulations thereunder.

7. Trading Halts

The Exchange additionally proposes to modify Interpretation and Policy .01 to Exchange Rule 20.3 (Trading Halts), which describes the Exchange’s authority to declare trading halts in one or more options traded on the Exchange. Currently, Interpretation and Policy .01 states that the Exchange “may” nullify any transaction that occurs: (a) during a trading halt in the affected option on the Exchange; or (b) with respect to equity options (including options overlying ETFs), during a trading halt on the primary listing market for the underlying security. To ensure consistency with the trading halt provision of Proposed Rule 20.6, the Exchange proposes to modify Interpretation and Policy .01 to Exchange Rule 20.3 to state that in either situation described above, the Exchange “shall” nullify such transactions.

8. Erroneous Print and Quotes in Underlying Security

The Exchange proposes to adopt language in the Proposed Rule stating that a trade resulting from an erroneous print(s) disseminated by the underlying market that is later nullified by that underlying market shall be adjusted or busted as set forth in the Obvious Error provisions

of the Proposed Rule, provided a party notifies the Exchange's Trade Desk in a timely manner, as further described below. The Exchange proposes to define a trade resulting from an erroneous print(s) as any options trade executed during a period of time for which one or more executions in the underlying security are nullified and for one second thereafter. The Exchange also proposes to require that if a party believes that it participated in an erroneous transaction resulting from an erroneous print(s) pursuant to the proposed erroneous print provision it must notify the Exchange's Trade Desk within the timeframes set forth in the Obvious Error provision described above. The Exchange has also proposed to state that the allowed notification timeframe commences at the time of notification by the underlying market(s) of nullification of transactions in the underlying security. Further, the Exchange proposes that if multiple underlying markets nullify trades in the underlying security, the allowed notification timeframe will commence at the time of the first market's notification.

The Exchange also proposes to add a provision stating that a trade resulting from an erroneous quote(s) in the underlying security shall be adjusted or busted as set forth in the Obvious Error provisions of the Proposed Rule, provided a party notifies the Exchange's Trade Desk in a timely manner, as further described below. Pursuant to the Proposed Rule, an erroneous quote occurs when the underlying security has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such underlying security during the time period encompassing two minutes before and after the dissemination of such quote. For purposes of the Proposed Rule, the average quote width will be determined by adding the quote widths of sample quotations at regular 15-second intervals during the four-minute time period referenced above (excluding the quote(s) in question) and dividing by the number of quotes

during such time period (excluding the quote(s) in question).¹¹ Similar to the proposal with respect to erroneous prints described above, if a party believes that it participated in an erroneous transaction resulting from an erroneous quote(s) it must notify the Exchange's Trade Desk in accordance with the notification provisions of the Obvious Error provision described above.

9. Stop (and Stop-Limit) Order Trades Triggered by Erroneous Trades

As proposed, transactions resulting from the triggering of a stop or stop-limit order by an erroneous trade in an option contract shall be nullified by the Exchange, provided a party notifies the Exchange's Trade Desk in a timely manner as set forth below. If a party believes that it participated in an erroneous transaction pursuant to the Proposed Rule it must notify the Exchange's Trade Desk within the timeframes set forth in the Obvious Error rule above, with the allowed notification timeframe commencing at the time of notification of the nullification of transaction(s) that triggered the stop or stop-limit order.

10. Linkage Trades

The Exchange also proposes to adopt language that provides the Exchange with authority to take necessary actions when another options exchange nullifies or adjusts a transaction pursuant to its respective rules and the transaction resulted from an order that has passed through the Exchange and been routed on to another options exchange on behalf of the Exchange. Specifically, if the Exchange routes an order pursuant to the Intermarket Option Linkage Plan¹² that results in a transaction on another options exchange (a "Linkage Trade") and such options exchange subsequently nullifies or adjusts the Linkage Trade pursuant to its rules, the Exchange

¹¹ The Exchange has proposed the price and time parameters for quote width and average quote width used to determine whether an erroneous quote has occurred based on established rules of options exchanges that currently apply such parameters. See, e.g., CBOE Rule 6.25(a)(5); NYSE Arca Rule 6.87(a)(5).

¹² As defined in Exchange Rule 27.1(17).

will perform all actions necessary to complete the nullification or adjustment of the Linkage Trade. Although the Exchange is not utilizing its own authority to nullify or adjust a transaction related to an action taken on a Linkage Trade by another options exchange, the Exchange does have to assist in the processing of the adjustment or nullification of the order, such as notification to the Member and the OCC of the adjustment or nullification.

11. Appeals

The Exchange proposes to maintain its current appeals process in connection with the Proposed Rule. Specifically, if a member of BATS Options (“Options Member”) affected by a determination made under the Proposed Rule requests within the time permitted below, the Obvious Error Panel will review decisions made by the BATS Official, including whether an obvious error occurred and whether the correct determination was made.

The Obvious Error Panel will be comprised of the Exchange’s Chief Regulatory Officer (“CRO”) or a designee of the CRO, a representative of one (1) Options Member engaged in market making (any such representative, a “MM Representative”) and representatives from two (2) Options Members satisfying one or both of the criteria set forth below (any such representative, a “Non-MM Representative”). To qualify as a Non-MM Representative a person must: be employed by an Options Member whose revenues from options market making activity do not exceed ten percent (10%) of its total revenues; or have as his or her primary responsibility the handling of Public Customer orders or supervisory responsibility over persons with such responsibility, and not have any responsibilities with respect to market making activities.

The Exchange shall further designate at least ten (10) MM Representatives and at least ten (10) Non-MM Representatives to be called upon to serve on the Obvious Error Panel as needed. To assure fairness, in no case shall an Obvious Error Panel include a person affiliated

with a party to the trade in question. Also, to the extent reasonably possible, the Exchange shall call upon the designated representatives to participate on an Obvious Error Panel on an equally frequent basis.

Under the Proposed Rule a request for review on appeal must be made in writing via e-mail or other electronic means specified from time to time by the Exchange in a circular distributed to Options Members within thirty (30) minutes after the party making the appeal is given notification of the initial determination being appealed. The Obvious Error Panel shall review the facts and render a decision as soon as practicable, but generally on the same trading day as the execution(s) under review. On requests for appeal received after 3:00 p.m. Eastern Time, a decision will be rendered as soon as practicable, but in no case later than the trading day following the date of the execution under review.

The Obvious Error Panel may overturn or modify an action taken by the BATS Official under this Rule. All determinations by the Obvious Error Panel shall constitute final action by the Exchange on the matter at issue.

If the Obvious Error Panel votes to uphold the decision made pursuant to the Proposed Rule, the Exchange will assess a \$500.00 fee against the Options Member(s) who initiated the request for appeal. In addition, in instances where the Exchange, on behalf of an Options Member, requests a determination by another market center that a transaction is clearly erroneous, the Exchange will pass any resulting charges through to the relevant Options Member.

Any determination by an Officer or by the Obvious Error Panel shall be rendered without prejudice as to the rights of the parties to the transaction to submit their dispute to arbitration.

12. Limit Up-Limit Down Plan

The Exchange is proposing to adopt Interpretation and Policy .01 to Proposed Rule 20.6 (“LULD Options Pilot”) to provide for how the Exchange will treat Obvious and Catastrophic Errors in response to the Regulation NMS Plan to Address Extraordinary Market Volatility Pursuant to Rule 608 of Regulation NMS under the Act (the “Limit Up-Limit Down Plan” or the “Plan”),¹³ which is applicable to all NMS stocks, as defined in Regulation NMS Rule 600(b)(47).¹⁴ Under the Proposed Rule, during a pilot period to coincide with the pilot period for the Plan,¹⁵ including any extensions to the pilot period for the Plan, an execution will not be subject to review as an Obvious Error or Catastrophic Error pursuant to paragraph (c) or (d) of the Proposed Rule if it occurred while the underlying security was in a “Limit State” or “Straddle State,” as defined in the Plan. The Exchange, however, proposes to retain authority to review transactions on an Official’s own motion pursuant to sub-paragraph (c)(3) of the Proposed Rule and to bust or adjust transactions pursuant to the proposed SME provision, the proposed trading halts provision, the proposed provisions with respect to erroneous prints and quotes in the underlying security, or the proposed provision related to stop and stop limit orders that have been triggered by an erroneous execution.

During a Limit or Straddle State, options prices may deviate substantially from those available immediately prior to or following such States. Thus, determining a Theoretical Price in such situations would often be very subjective, creating unnecessary uncertainty and confusion for investors. Because of this uncertainty, the Exchange is proposing to amend Rule 20.6 to provide that the Exchange will not review transactions as Obvious Errors or Catastrophic Errors

¹³ Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (order approving the Plan on a pilot basis).

¹⁴ 17 CFR 242.600(b)(47).

¹⁵ The Commission notes that the Exchange has amended its LULD Options Pilot date from August 20, 2015 to October 23, 2015. See Amendment No. 2, supra note 6.

when the underlying security is in a Limit or Straddle State.

The Exchange notes that there are additional protections in place outside of the Obvious and Catastrophic Error Rule that will continue to safeguard customers. First, the Exchange rejects all un-priced options orders received by the Exchange (i.e., Market Orders) during a Limit or Straddle State for the underlying security. Second, SEC Rule 15c3-5 requires that, “financial risk management controls and supervisory procedures must be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds, or that appear to be erroneous.”¹⁶ Third, the Exchange has price checks applicable to limit orders that reject limit orders that are priced sufficiently far through the national best bid or national best offer (“NBBO”) that it seems likely an error occurred. The rejection of Market Orders, the requirements placed upon broker dealers to adopt controls to prevent the entry of orders that appear to be erroneous, and Exchange functionality that filters out orders that appear to be erroneous, will all serve to sharply reduce the incidence of erroneous transactions.

The Exchange has agreed to provide the Commission with relevant data to assess the impact of this proposed rule change. As part of its analysis, the Exchange will evaluate (1) the options market quality during Limit and Straddle States, (2) assess the character of incoming order flow and transactions during Limit and Straddle States, and (3) review any complaints from Members and their customers concerning executions during Limit and Straddle States. The Exchange has also agreed to provide to the Commission data requested to evaluate the impact of the inapplicability of the Obvious Error and Catastrophic Error provisions, including data relevant to assessing the various analyses noted above.

In connection with this proposed rule change, the Exchange will provide to the

¹⁶ See Securities and Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69791 (November 15, 2010) (File No. S7-03-10).

Commission and the public a dataset containing the data for each Straddle State and Limit State in NMS Stocks underlying options traded on the Exchange beginning in the month during which the proposed rule change is approved, limited to those option classes that have at least one (1) trade on the Exchange during a Straddle State or Limit State. For each of those option classes affected, each data record will contain the following information:

- Stock symbol, option symbol, time at the start of the Straddle or Limit State, an indicator for whether it is a Straddle or Limit State.
- For activity on the Exchange:
 - executed volume, time-weighted quoted bid-ask spread, time-weighted average quoted depth at the bid, time-weighted average quoted depth at the offer;
 - high execution price, low execution price;
 - number of trades for which a request for review for error was received during Straddle and Limit States;
 - an indicator variable for whether those options outlined above have a price change exceeding 30% during the underlying stock's Limit or Straddle State compared to the last available option price as reported by OPRA before the start of the Limit or Straddle State (1 if observe 30% and 0 otherwise). Another indicator variable for whether the option price within five minutes of the underlying stock leaving the Limit or Straddle state (or halt if applicable) is 30% away from the price before the start of the Limit or Straddle State.

In addition, by May 29, 2015, the Exchange shall provide to the Commission and the

public assessments relating to the impact of the operation of the Obvious Error rules during Limit and Straddle States as follows: (1) Evaluate the statistical and economic impact of Limit and Straddle States on liquidity and market quality in the options markets; and (2) Assess whether the lack of Obvious Error rules in effect during the Straddle and Limit States are problematic. The timing of this submission would coordinate with Participants' proposed time frame to submit to the Commission assessments as required under Appendix B of the Plan. The Exchange notes that the pilot program is intended to run concurrent with the pilot period of the Plan, which has been extended to October 23, 2015. The Exchange proposes to reflect this date in the Proposed Rule.

13. No Adjustments to a Worse Price

Finally, the Exchange proposes to include Interpretation and Policy .02 to the Proposed Rule, which would make clear that to the extent the provisions of the proposed Rule would result in the Exchange applying an adjustment of an erroneous sell transaction to a price lower than the execution price or an erroneous buy transaction to a price higher than the execution price, the Exchange will not adjust or nullify the transaction, but rather, the execution price will stand.

Additional information relating to the proposed rule change can be found in the Notice.¹⁷ The Exchange has proposed that this proposed rule change become effective on May 8, 2015. The Exchange notes that this delayed implementation is to ensure that other options exchanges will have sufficient time to adopt similar rules consistent with the proposed rule change and to coordinate the effectiveness of such harmonized rules.

III. Discussion of Comment Letters and Commission Findings

As noted previously, the Commission received two comment letters on the proposed rule

¹⁷ See supra note 3.

change and a response letter from the Exchange.¹⁸ Both commenters generally support the principles underlying the proposed rule change, including greater transparency and more consistent results for investors, market participants, and the public regarding the handling of nullification and adjustment of options transactions including obvious erroneous transactions.¹⁹ Both commenters applaud the Exchange's effort to adopt a harmonized rule related to the adjustment of erroneous options transactions, as well as a specific provision related to coordination in connection with SMEs.²⁰ However, both commenters provide additional suggestions for the proposed rule change and further encourage the Commission to continue to work with the Exchange and the other options exchanges and market participants to consider ways to develop increased pre-trade risk controls on exchanges, which could prevent erroneous trades before they occur.²¹ The Exchange has responded to the commenters, as discussed below.²²

A. Summary of Comment Letters Received

The Goldman Letter supports the goal and much of the substance of the Proposed Rule, including the efforts to ensure predictability in the case of an SME.²³ However, the Goldman Letter believes that, in the case of an SME, BATS and other impacted exchanges should nullify all affected trades.²⁴ The Goldman Letter argues that providing a higher degree of certainty in the outcome during such an event would reduce residual economic harm to the parties involved and

¹⁸ See supra notes 4-5.

¹⁹ See Goldman Letter, supra note 4; SIFMA Letter, supra note 4.

²⁰ See id.

²¹ See id.

²² See BATS Response Letter, supra note 5.

²³ See Goldman Letter, supra note 4, at 1-2.

²⁴ See id. at 3.

would promote a timely remediation of the event without unnecessary delay and uncertainty.²⁵

The SIFMA Letter generally supports the proposed rule change, but notes that there are critical aspects that will require additional time to allow for exchange and industry discussion, including the development of a method to ensure greater objectivity and uniformity with respect to the calculation of Theoretical Price.²⁶ SIFMA also supports the use of a third party vendor system that would generate theoretical values, and encourages the exchanges to work expeditiously towards accomplishing such a goal.²⁷

The Goldman and SIFMA Letters both advocate for the Commission and the exchanges to work towards the establishment of pre-trade controls designed to prevent erroneous trades before they occur.²⁸ Both commenters believe this can be accomplished through a set of pre-trade risk controls (e.g., kill switches), and SIFMA also believes this can be further accomplished with post-trade risk controls, both designed to reduce the frequency and magnitude of market disruptions.²⁹

In its response to commenters, the Exchange reiterates its belief that the Proposed Rule will provide greater transparency and finality with respect to the adjustment and nullification of erroneous options transactions.³⁰ The Exchange notes that it agrees with the commenters' suggestions that it continue to work towards additional objectivity and uniformity with respect to the calculation of Theoretical Price and that it pursue other tools to prevent erroneous transactions, including pre-trade risk functionality.³¹ In addition, the Exchange emphasizes its commitment to

²⁵ See id.

²⁶ See SIFMA Letter, supra note 4, at 3.

²⁷ See id.

²⁸ See Goldman Letter, supra note 4, at 3-4; and SIFMA Letter, supra note 4, at 3.

²⁹ See id.

³⁰ See BATS Response Letter, supra note 5, at 1-2.

³¹ See id. at 2.

working with other options exchanges, SIFMA, and market participants in connection with such initiatives.³²

With respect to the proposal to adjust or nullify erroneous transactions in connection with an SME, the Exchange notes that the Proposed Rule would permit the Exchange to coordinate with other options exchanges in certain circumstances and would provide limited flexibility in the application of the general obvious error provisions of the Proposed Rule in order to allow the Exchange to promptly respond to a widespread market event that meets the criteria of an SME.³³ Such coordination would be used to determine the specific points in time to be used to determine Theoretical Price, as well as whether or not timely adjustment of affected transactions would be feasible.³⁴ The Exchange acknowledges the concern presented in the Goldman Letter and reiterates that the Proposed Rule allows the Exchange to nullify some or all transactions arising out of an SME if timely adjustments are not feasible.³⁵ However, the Exchange notes its belief that long-standing principles in the options market support the need for adjustments when they can reasonably be provided.³⁶ The Exchange states that because market participants, and particularly liquidity providers, commonly engage in hedging transactions, adjustments are necessary when possible to limit the potential negative economic impact to such participants, which is magnified during an SME.³⁷ Moreover, the Exchange believes the Proposed Rule adequately balances the competing interests of mitigating harm through the longstanding practice of timely adjusting erroneous options trades and the need for certainty when timely adjustments are not feasible by

³² See id.

³³ See id. at 2-3.

³⁴ See id.

³⁵ See id. at 3.

³⁶ See id.

³⁷ See id.

preserving the discretion to nullify some or all transactions arising out of an SME.³⁸

B. Commission Findings

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.³⁹ In particular, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of Section 6(b) of the Act⁴⁰ and with Section 6(b)(5) of the Act,⁴¹ which requires, among other things, that the Exchange's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, 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.

The Commission believes that the proposal to adopt Rule 20.6 will help assure greater objectivity, transparency, and clarity with respect to the adjustment and nullification of erroneous options transactions. The Commission notes that the Proposed Rule is designed to achieve more consistent results for participants across U.S. options exchanges than under the current rules while maintaining a fair and orderly market, protecting investors, and protecting the public interest. In the Commission's view, the proposed rule change will help assure that the determination of whether an erroneous options transaction has occurred will generally be based on clear and objective criteria, and that the resolution of the incident will occur promptly through a transparent process. Based on the foregoing, the Commission believes that the proposed rule

³⁸ See id.

³⁹ In approving this proposed rule change, as amended, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁴⁰ 15 U.S.C. 78f(b).

⁴¹ 15 U.S.C. 78f(b)(5).

change is consistent with Section 6(b)(5) of the Act⁴² in that Proposed Rule 20.6 will foster cooperation and coordination with persons engaged in regulating and facilitating transactions.

The Commission notes that the Exchange represented in its filing that the Exchange and all other options exchanges have been working to further improve the review of potentially erroneous transactions as well as their subsequent adjustment by creating a more objective and uniform way to determine Theoretical Price in the event a reliable NBBO is not available, as in, for example, such cases where there is a wide quote or no valid quote, as described above.⁴³ Specifically, the Exchange and all other options exchanges are considering utilizing an independent third party to calculate and disseminate or make available Theoretical Price in order to better achieve uniform results during an event in which a potentially erroneous transaction involving the same option is under review at more than one exchange.⁴⁴ The Exchange notes, however, that this initiative requires additional Exchange and industry discussion as well as additional time for development and implementation.⁴⁵ The Commission expects the Exchange and the other national securities exchanges to continue to work with other options exchanges and the options industry towards the goal of additional objectivity and uniformity with respect to the calculation of Theoretical Price in these circumstances.

The Commission appreciates the suggestions and responses offered by both commenters to improve the process by which the Exchange addresses the harmonization of rules related to the adjustment and nullification of erroneous options transactions.⁴⁶ The Commission believes

⁴² 15 U.S.C. 78f(b)(5).

⁴³ See Notice, supra note 3, at 77558.

⁴⁴ See id.

⁴⁵ See id.

⁴⁶ See SIFMA Letter, supra note 4, at 3; and Goldman Letter, supra note 4, at 3-4. In addition, the Commission acknowledges the comment that the Commission and the

that the proposed rule changes represent a significant first step by the options exchanges to bring greater clarity and transparency to the process for the adjustment and nullification of erroneous options transactions, and that these improvements should not be delayed pending consideration of further initiatives. The Commission notes that the Exchange intends to continue to work with other options exchanges and market participants to further develop, as appropriate, additional objectivity with respect to their processes for the adjustment and nullification of erroneous options transactions.⁴⁷ Regarding the comment that the Exchange should nullify all affected transactions when an SME has occurred,⁴⁸ the Commission believes that the Exchange's approach to permit transactions that occur during an SME to be adjusted in certain circumstances is reasonable, as adjustments may limit the potential negative impact to market participants who commonly engage in hedging transactions.

Finally, the Commission notes that the proposed rule change will become operative on May 8, 2015. This delayed implementation is to ensure that other options exchanges will have sufficient time to put in place similar rules consistent with this proposed rule change and to coordinate the date of implementation of such harmonized rules.

IV. Solicitation of Comments on Amendment No. 2

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 2 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

exchanges work towards the establishment of pre-trade controls designed to prevent erroneous trades before they occur but believes that such comment is outside the scope of the proposed rule change. See id.

⁴⁷ See Notice, supra note 3, at 77558; BATS Response Letter, supra note 5, at 2.

⁴⁸ See Goldman Letter, supra note 4, at 3.

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>);
or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-BATS-2014-067 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-BATS-2014-067. 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-2014-067 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 2

The Commission finds good cause to approve the proposed rule change, as modified by Amendment Nos. 1 and 2, prior to the 30th day after the date of publication of notice of Amendment No. 2 in the Federal Register. As discussed above, Amendment No. 2 revised the proposed rule change by: (1) making technical, non-substantive corrections to the definition of “Size Adjustment Modifier” in paragraph (a)(4) of Proposed Rule 20.6 and the criterion used to measure the occurrence of a Significant Market Event in paragraph (e)(1) of Proposed Rule 20.6; (2) amending the description in paragraph (b) of Proposed Rule 20.6 to use the last NBB and last NBO prior to the Exchange’s receipt of an order as the Theoretical Price for determining the execution price at all price levels when a single order is executed at multiple price levels; (3) updating the expiration date of the pilot program related to the suspension of certain provisions of the Proposed Rule to October 23, 2015 in connection with the Limit Up-Limit Down Plan and making clear that the Exchange would provide a publicly available assessment of the operation of this portion of the Proposed Rule by May 29, 2015; and (4) proposing an implementation date of May 8, 2015 to allow all the other options exchanges the time necessary to harmonize their rules with the Proposed Rule.⁴⁹

The Commission believes Amendment No. 2 would provide market participants with additional clarity by making technical, non-substantive corrections to certain portions of the filing.⁵⁰ The Commission believes the amendment to the determination of Theoretical Price when a single order is executed at multiple price levels is consistent with the protection of investors because the revised provision provides additional certainty to market participants and eliminates the discretion of the Exchange to determine Theoretical Price in certain

⁴⁹ See Amendment No. 2, supra note 6.

⁵⁰ See id.

circumstances.⁵¹ The Commission further believes that approval of the proposed rule change, as modified by Amendment Nos. 1 and 2, on an accelerated basis would permit other options exchanges to complete the process of filing similar proposals to adopt the new, harmonized rule on a timely basis.⁵²

As discussed above, the Commission believes that the revisions in Amendment No. 2 are being made to provide additional clarity to the proposed rule change and to provide additional certainty and consistency by eliminating the discretion of the Exchange to determine Theoretical Price in certain circumstances. The Commission believes Amendment No. 2 is consistent with the purpose of the proposed rule change and is consistent with the protection of investors and the public interest. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,⁵³ to approve the proposed rule change, as modified by Amendment Nos. 1 and 2, on an accelerated basis.

⁵¹ See id.

⁵² See id.

⁵³ 15 U.S.C. 78s(b)(2).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁵⁴ that the proposed rule change, as modified by Amendment Nos. 1 and 2 (SR-BATS-2014-067) be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵⁵

Brent J. Fields,
Secretary.

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⁵⁴ 15 U.S.C. 78s(b)(2).

⁵⁵ 17 CFR 200.30-3(a)(12).