

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71651; File No. SR-BATS-2014-003)

March 5, 2014

Self-Regulatory Organizations; BATS Exchange, Inc.; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Modify the BATS Options Opening Process

I. Introduction

On January 6, 2014, BATS Exchange, Inc. (“Exchange” or “BATS”) filed with the Securities and Exchange Commission (“Commission”) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to modify the BATS options opening process. On January 16, 2014, the Exchange filed Amendment No. 1 to the proposed rule change.³ The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on January 23, 2014.⁴ The Commission received no comments on the proposal. This order approves the proposed rule change, as modified by Amendment No. 1.

II. Description of the Proposal

The Exchange proposes to amend its rules to allow the Exchange’s equity options trading platform (“BATS Options”) to accept orders and quotes in all options series, other than index options, prior to the first transaction in the underlying security on the primary listing market and during a halt, as well as to establish a process for matching such orders immediately prior to the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, the Exchange corrected a typographical error contained in its original submission related to its description of how the Exchange’s Rule 20.6, governing Obvious Errors, currently operates.

⁴ See Securities Exchange Act Release No. 71327 (January 16, 2014), 79 FR 3897 (January 23, 2014) (“Notice”).

opening of trading in such options series. According to the Exchange, BATS Options currently does not accept any orders or quotes while trading is not open in an options class, including both prior to the first transaction in the underlying security on the primary listing market and during a trading halt in an options class.⁵

The Exchange proposes to begin accepting orders and quotes in all series at 8:00 a.m. Eastern Time and immediately upon a regulatory halt,⁶ and would continue to accept orders and quotes until such time as the BATS Options opening process is initiated (“Order Entry Period”).⁷ Under the proposal, such orders (i.e., those received prior to the opening process or during a regulatory halt) will be queued for participation in the opening process and will not be eligible for execution until the opening process occurs.⁸ The Exchange proposes that limit orders queued during this time would be disseminated via the Options Price Reporting Authority (“OPRA”) as non-firm quotes and via BATS Multicast PITCH, but that market orders queued during this time would not be disseminated.⁹

⁵ Id. According to the Exchange, BATS Options currently opens trading in options: (i) after the first transaction on the primary listing market after 9:30 a.m. Eastern Time in the securities underlying the options as reported on the first print disseminated pursuant to an effective national market system plan; or (ii) any time after 9:30 a.m. Eastern Time where the Exchange determines that the interests of a fair and orderly market are best served by opening trading in the options contracts. Id. During a trading halt in an options class, the Exchange states that it currently cancels all orders and quotes, and trading does not resume until the Exchange determines that the conditions that led to the halt are no longer present or that the interests of a fair and orderly market are best served by a resumption of trading. Id.

⁶ See proposed BATS Rule 21.7(a), defining “Regulatory Halt” as “trading being halted in an option series due to the primary listing market for the applicable underlying security declaring a regulatory trading halt, suspension, or pause with respect to such security.”

⁷ See Notice, supra note 4, at 3897.

⁸ Id. The Exchange also notes that “Immediate or Cancel” orders (“IOCs”) or “WAIT” orders will not be accepted for queuing prior to completion of the opening process. Id. See also BATS Rule 21.1(f)(2) and (4) (defining IOC and WAIT orders).

⁹ See Notice, supra note 4, at 3897.

During a regulatory halt, the Exchange proposes that all orders would be cancelled unless an exchange member has entered instructions not to cancel its orders,¹⁰ which would cause such orders to queue as part of the Order Entry Period.¹¹ However, when trading is halted, but it is not due to a regulatory halt, the Exchange proposes that there would be no Order Entry Period, all orders would be canceled, and trading would resume upon a determination by the Exchange that the conditions which led to the halt are no longer present or that the interests of a fair and orderly market are best served by a resumption of trading.¹²

The Exchange also proposes a method for determining the opening price¹³ of an options series at the time of opening or after trading resumes following a regulatory halt. Specifically, the Exchange proposes that, where there are no contracts in a particular series that would execute at any price at the time that the Exchange would determine the opening price, the Exchange would open such options for trading without determining an opening price.¹⁴ Where there is a price at which at least one contract would execute, the Exchange proposes that, within thirty seconds after the first listing market transaction¹⁵ or the regulatory halt being lifted, the Exchange would determine the opening price under proposed BATS Rule 21.7(a)(1) as follows:
(i) the midpoint of the national best bid (“NBB”) and the national best offer (“NBO” and,

¹⁰ Id.

¹¹ Id.

¹² Id.

¹³ See proposed BATS Rule 21.7(a)(1) (defining “Opening Price” as “a single price at which a particular option series will be opened”).

¹⁴ See Notice, supra note 4, at 3897.

¹⁵ See proposed BATS Rule 21.7(a) (defining “First Listing Market Transaction” as “the first transaction on the primary listing market after 9:30 a.m. Eastern Time in the securities underlying the options as reported on the first print disseminated pursuant to an effective national market system plan”).

collectively, the “NBBO Midpoint”);¹⁶ (ii) where there is no NBBO Midpoint at a “Valid Price” (as explained below), the last “Print”¹⁷ in the series; or (iii) where there is neither a NBBO Midpoint nor a Print at a Valid Price, the “Previous Close.”¹⁸

The Exchange proposes that the opening price of an options series must be a Valid Price.¹⁹ The Exchange further proposes that a NBBO Midpoint, a Print, and a Previous Close would constitute a Valid Price under proposed BATS Rule 21.7(a)(2) where: (i) there is no NBB and no NBO; (ii) there is either a NBB and no NBO or a NBO and no NBB and the price is equal to or greater than the NBB or equal to or less than the NBO; or (iii) there is both a NBB and NBO, the price is equal to or within the NBBO, and the price is less than a prescribed “Minimum Amount” away from the NBB or NBO for the series.²⁰ The Exchange proposes to establish the Minimum Amount thresholds based on the standards set forth in BATS Rule 20.6 governing Obvious Errors.²¹

Where there is no NBBO Midpoint, no Print, and no Previous Close at a Valid Price, the Exchange proposes to have the discretion, depending on the circumstances, to extend the Order

¹⁶ The Exchange proposes that, where the NBBO Midpoint would result in an opening price in a sub-penny increment, the Exchange will use the next highest non sub-penny increment as the NBBO Midpoint. See Notice, supra note 4, at 3898.

¹⁷ See proposed BATS Rule 21.7(a)(1)(B) (defining “Print” as “the last regular way print disseminated pursuant to the OPRA Plan after 9:30 a.m. Eastern Time”).

¹⁸ See proposed BATS Rule 21.7(a)(1)(C) (defining “Previous Close” as “the last regular way transaction from the previous trading day as disseminated pursuant to the OPRA Plan”).

¹⁹ See proposed BATS Rule 21.7(a)(1).

²⁰ The prescribed Minimum Amount away thresholds would vary based on the price of the NBB. See proposed BATS Rule 21.7(a)(2)(C) (laying out the applicable Minimum Amount thresholds). For example, if the NBB for an option series is below \$2.00, the applicable Minimum Amount threshold would be \$0.25. Id.

²¹ See Notice, supra note 4, at 3898.

Entry Period by 30 seconds or less, or open the series for trading.²² Where the Exchange decides to open the series for trading pursuant to this discretion and there is at least one price level at which at least one contract of a limit order could be executed, the Exchange proposes to cancel all orders that are priced equal to or more aggressively than the midpoint of the most aggressively priced bid and the most aggressively priced offer.²³

After the Exchange determines that an opening price is also a Valid Price, the Exchange proposes that orders and quotes that are priced equal to or more aggressively than the Opening Price would be matched based on price-time priority and in accordance with BATS Rule 21.8.²⁴ Further, under the proposal, all orders and quotes or portions thereof that are matched pursuant to the opening process would be executed at the opening price.²⁵ The Exchange also proposes that certain orders, or portions thereof, that are not executed during the opening process would be canceled.²⁶ For all other orders and quotes that have not been executed or canceled, including where no orders are matched at the opening price, the Exchange proposes that such orders will become eligible for trading on BATS Options immediately following the completion of the opening process.²⁷

The Exchange also proposes to add some additional clarity to how trading will open and resume following a trading halt for index options. First, the Exchange represents that it would open index options in exactly the same manner as they open currently—at 9:30 a.m. Eastern

²² Id.

²³ Id. (providing an example of how this would operate).

²⁴ Id.

²⁵ Id.

²⁶ See Notice, supra note 4, at 3898. Under the proposal, this provision would apply to: (i) limit orders that are priced equal to or more aggressively than the opening price; and (ii) market orders. Id.

²⁷ See Notice, supra note 4, at 3898-99.

Time.²⁸ Second, the Exchange proposes that, where trading in index options is halted for any reason, BATS would open such options for trading upon the determination by the Exchange that the conditions which led to the halt are no longer present or that the interests of a fair and orderly market are best served by a resumption of trading.²⁹ According to the Exchange, this too is how index options open after a trading halt under the current rules,³⁰ and the purpose of this change is to clarify that trading in index options is not subject to the opening process, described above, under proposed BATS Rule 21.7(a).³¹

Finally, the Exchange proposes to retain discretion to deviate from its standard opening process, including adjusting the timing of the opening process in any option class, when the Exchange believes it is necessary in the interests of a fair and orderly market.³² Currently, in the event the underlying security has not opened within a reasonable time after 9:30 a.m. Eastern Time, the Exchange shall make an inquiry to determine the cause of the delay, and the Exchange can open trading in options contracts even if the underlying security has yet to open for trading on the primary listing market for such security if the Exchange determines that the interests of a fair and orderly market are best served by opening trading in the options contracts.³³ In addition, the Exchange may delay the commencement of trading in any class of options in the interests of a fair and orderly market.³⁴ Under the proposal, the Exchange could open trading in options

²⁸ See Notice, supra note 4, at 3899.

²⁹ Id.

³⁰ Id. The Exchange also notes that the opening process for index options is not being changed by this proposed rule change. Id.

³¹ Id.

³² Id.

³³ See BATS Rule 21.7(b); Notice, supra note 4, at 3899.

³⁴ See BATS Rule 21.7(c); Notice, supra note 4, at 3899.

contracts prior to the first listing market transaction and also delay the commencement of trading in any class of options, so long as it is in the interests of a fair and orderly market, and the Exchange would have discretion to manage the Opening Process in the event of unanticipated circumstances occurring around 9:30 a.m. Eastern Time or a trading halt being lifted.³⁵

III. Discussion and Commission Findings

After careful review of the proposal, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange.³⁶ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,³⁷ which requires, among other things, that the rules of a national securities exchange 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.

As described above, the Exchange proposes, among other things, to begin accepting orders and quotes for options series, other than index options, prior to the first transaction in the underlying security on the primary listing market and during certain trading halts. According to the Exchange, this will provide all Exchange members with greater control and flexibility with respect to entering orders and quotes by allowing them to enter orders and quotes beginning at 8:00 a.m. Eastern Time, rather than only after trading has opened for a particular option. Under the proposal, orders entered during the opening process or certain trading halts would queue, and

³⁵ See Notice, supra note 4, at 3899.

³⁶ In approving the proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

³⁷ 15 U.S.C. 78f(b)(5).

all orders and quotes priced more aggressively than the opening price will be matched based on price-time priority and in accordance with existing BATS Rule 21.8. Further, all orders and quotes or portions thereof that are matched during the opening process will be executed at the opening price. The Commission notes that limit orders queued during the opening process would be disseminated via OPRA, which will contribute toward greater price discovery by providing additional information to the options market.

The Commission believes that permitting BATS to accept orders and quotes before 9:30 a.m. Eastern Time and during certain trading halts should benefit investors by providing them certainty as to when their orders and quotes can be submitted rather than having to monitor each options class individually. By offering this additional functionality to Exchange members, the Commission believes that the proposed rule change is reasonably designed to remove impediments to a free and open market. The Commission also notes that several other exchanges already permit their members to submit orders and quotes prior to 9:30 a.m. Eastern Time and during trading halts.³⁸

As described above, the Exchange proposes to establish a method for determining an opening price for options, other than index options, and require that any opening price be a Valid Price. The opening price would be: (i) the NBBO Midpoint; (ii) where there is no NBBO Midpoint at a Valid Price, the Print; or (iii) where there is neither a NBBO Midpoint nor a Print at a Valid Price, the Previous Close. Accordingly, the Exchange will look to the most recently available market prices to determine the opening price, but will, in no case, permit an opening price that is not a Valid Price. To this end, the Exchange proposes to adopt Minimum Amount thresholds derived from the Exchange's obvious error rules to ensure that the opening price for

³⁸ See, e.g., NASDAQ Options Market Chapter VI, Section 2(a); NYSE Arca Rule 6.64; NYSE MKT Rule 952NY.

an options series is, in the Exchange's view, appropriately priced. The Exchange believes that using these thresholds will prevent obvious error transactions by ensuring that the opening price will be within the Minimum Amount from either the NBB or NBO when there is both a NBB and NBO.³⁹ Accordingly, the Commission believes that the Exchange's proposal is reasonably designed to protect investors and the public interest by establishing an opening process that should limit an opening price to a price that should be related to the current market for an option. The Commission notes that, if the Exchange determines to open an option series for trading without determining an opening price and there is at least one price level at which at least one contract of a limit order could be executed, the Exchange would cancel all orders that are priced equal to or more aggressively than the midpoint of the most aggressively priced bid and the most aggressively priced offer, which should allow the Exchange to effectively open the series for trading.

The Commission further believes that the proposed opening process, including the ability to deviate from such opening process in the interests of a fair and orderly market, is consistent with the protection of investors and the public interest because it should help BATS open trading in options contracts in a fair and orderly manner. Specifically, the Commission believes that allowing members to enter orders for queuing should create a more orderly opening and facilitate price formation at the opening of trading because members will be able to enter orders and quotes in advance, rather than submitting them to the Exchange in a small amount of time. In addition, the Commission believes that the dissemination of this information prior to the opening of trading in options contracts should facilitate price discovery and create a more orderly opening

³⁹ See Notice, supra note 4, at 3899.

process because members will have access to more information before their orders become executable.

Finally, the Commission believes that the Exchange's proposal relating to the opening, and re-opening after a trading halt, of index options is designed to protect investors and the public interest by clarifying the Exchange's rules without affecting their functionality.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴⁰ that the proposed rule change, as modified by Amendment No. 1 thereto (SR-BATS-2014-003), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴¹

Kevin M. O'Neill
Deputy Secretary

⁴⁰ 15 U.S.C. 78s(b)(2).

⁴¹ 17 CFR 200.30-3(a)(12).