

BATS Exchange, Inc.

BZX Options Limit Up-Limit Down Assessment

Background

On December 4, BATS Exchange, Inc. (“BATS”) filed to replace in its entirety its existing rule governing the adjustment and nullification of erroneous options transactions that occur on its equity options platform (“BZX Options”), including transactions that qualify as “Obvious Errors” or “Catastrophic Errors”.¹ The Proposal, as amended, was approved by the Securities and Exchange Commission (“Commission”) on March 20, 2015.² In order to ensure coordination with other U.S. options exchanges, the effective date of the new Rule 20.6 was delayed until May 8, 2015.

As part of new Rule 20.6, the Exchange adopted Interpretation and Policy .01 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”),³ which is applicable to all NMS stocks, as defined in Regulation NMS Rule 600(b)(47).⁴ Under Interpretation and Policy .01, during a pilot period to coincide with the pilot period for the Plan, 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 notes that prior to the effective date of May 8, 2015, it did not have a comparable provision in its rules.

Data

Data regarding the operation of the Pilot is available at:

http://www.batsoptions.com/market_data/luld_reports/

To date, the Exchange has not received any requests for review of a transaction pursuant to Rule 20.6 when the underlying security was in a Limit State or Straddle State. Hereafter, a trade

¹ See Securities Exchange Act Release No. 73884 (December 18, 2014), 79 FR 77557 (December 27, 2014) (SR-BATS-2014-067) (Notice of Filing of a Proposed Rule Change, as Modified by Amendment No. 1, to Rule 20.6 of BATS Exchange, Inc.).

² See Securities Exchange Act Release No. 74556 (March 20, 2015), 80 FR 16031 (March 26, 2015) (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).

³ Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (order approving the Plan on a pilot basis).

⁴ 17 CFR 242.600(b)(47).

occurring when the underlying security was in a Limit State or Straddle State will be referred to as a “LULD Trade”.

During the time period from May 8, 2015 through May 29, 2015, the Exchange observed a total of 58 LULD Trades accounting for 1,432 contracts in options overlying 8 securities. Of these 58 LULD Trades, BATS observed 37 transactions for which the option trade price during a Limit State or Straddle State was more than 30% away from the last transaction prior to the security entering that state and 38 transactions for which option trade prices within 5 minutes of a security leaving a Straddle State or Limit State were more than 30% away from trade occurring during that state. The Exchange notes that the majority of the LULD Trades described above (38 out of 58) occurred in options overlying the security “AVP” on May 14, 2014. Below is a chart summarizing LULD Trades and volume per class during the time period.

Stock Symbol	Total LULD Volume	Total LULD Trades	Avg. Trade Size
ESI	4	1	4
AVP	1184	38	31
ANDE	4	1	4
XLNX	60	2	30
POM	12	1	12
DGX	142	13	11
BRCM	6	1	6
HUM	20	1	20

Analysis

BATS believes that there is insufficient data, particularly given the recent adoption of the pilot rule, to make a reliable statistical and economic evaluation of market quality in the options market during limit and straddle states.

BATS further believes that there is insufficient data to make a reliable assessment of whether the lack of obvious error rules in effect during straddle and limit states are problematic. As noted above, to date, the Exchange has not received any requests for review of a transaction pursuant to Rule 20.6 when the underlying security was in a Limit State or Straddle State. As such, BATS has not identified any problematic outcomes as a result of the pilot rule.