



March 4, 2015

VIA E-MAIL

Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

Re: Response to Comment Letters, Securities Exchange Act Release No. 34-73884 (December 18, 2014), 79 FR 77557 (December 24, 2014) (SR-BATS-2014-067) (“Proposal”)

Dear Mr. Fields:

BATS Exchange, Inc. (“BATS” or “Exchange”) appreciates the opportunity to respond to comment letters submitted in connection with the Proposal.<sup>1</sup> For the reasons set forth in the Proposal and in this response, the Exchange believes that its proposed rule change to modify the Exchange’s Rule 20.6 is consistent with Section 6(b)(5) of the Securities Exchange Act of 1934 (“Exchange Act”).<sup>2</sup> The Exchange therefore respectfully requests that the Securities and Exchange Commission (“Commission”) approve the Proposal.

Background

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

As described in the Proposal, for several months, at the direction of the Commission, 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 goal of the process that the options exchanges have undertaken is to adopt harmonized rules related to the adjustment and nullification of erroneous options transactions as well as a specific provision related to coordination in connection with large-scale events involving erroneous options transactions. As described below, the Exchange believes that the changes the options exchanges and the Exchange have agreed to propose will provide transparency and finality with

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<sup>1</sup> See Letter from Paul M. Russo, Managing Director, Goldman Sachs & Co., dated January 13, 2015 (“Goldman Letter”); Letter from Ellen Greene, Managing Director, SIFMA, dated January 28, 2015 (“SIFMA Letter”).

<sup>2</sup> 15 U.S.C. 78f(b)(5).

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.

### Comment Letters and Response

The Commission received two comment letters regarding the Proposal.<sup>3</sup> Both the SIFMA Letter and the Goldman Letter support the overall objective of the Proposal, particularly the harmonization of obvious and catastrophic error rules amongst all options exchanges. Both the SIFMA Letter and the Goldman Letter also provide comments on market structure topics that are relevant to the Proposal but that are not specifically addressed by the Proposed Rule. For instance, the SIFMA Letter supports the ongoing initiative that the Exchange and other options exchanges are working on to achieve additional objectivity and uniformity with respect to the calculation of Theoretical Price for obvious error purposes. Also, both the SIFMA Letter and the Goldman Letter support additional Commission-directed efforts by the Exchange and other options exchanges to expand pre-trade risk functionality and other tools to detect and prevent erroneous options transactions before they occur. The Exchange too believes that such efforts continue to be important and looks forward to working with other options exchanges, SIFMA, and market participants in connection with such initiatives.

The sole criticism of the Proposed Rule was set forth in the Goldman Letter and is described and addressed in further detail below.

Under the Proposal, the Exchange has proposed objective criteria that can be used to measure whether a large-scale market event, defined as a “Significant Market Event” or “SME”, has occurred.<sup>4</sup> In turn, as proposed, if an SME has occurred the Exchange will apply several aspects of the Proposed Rule that are generally applicable to any potentially erroneous transaction. For instance, other than coordinating on the time at which it should be measured, Theoretical Price would be determined in the same way that it would be determined with respect to any other execution or event. Similarly, the Exchange would adjust transactions using the same monetary criteria as in a typical Obvious Error situation (i.e., adjust based on Theoretical Price plus or minus \$0.15 for a transaction with a Theoretical Price below \$3.00 and Theoretical Price plus or minus \$0.30 for a transaction with a Theoretical Price at or above \$3.00). However, the Proposal does set forth certain potential outcomes in the context of an SME that differ from a transaction reviewed under the general Obvious Error provision.

First, outside of an SME, if a transaction qualifies as an Obvious Error pursuant to paragraph (c) of the Proposed Rule the Exchange would nullify any transaction involving a Customer but would adjust any transaction between non-Customers. However, in an SME, the Exchange would adjust all transactions, including Customer transactions, unless the parties to the transaction agreed otherwise or the adjustment price would be higher than a Customer’s

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<sup>3</sup> See supra note 1.

<sup>4</sup> The Exchange notes that the Goldman Letter generally supports the approach for determining whether an SME exists.

limit price for an order to buy or below a Customer's limit price for an order to sell. The Exchange notes that it has proposed the same handling for Catastrophic Errors (i.e., adjust all transactions unless the parties agree otherwise or it would violate a Customer's limit price).

Second, the Exchange has proposed that if the Exchange, in consultation with other options exchanges, determines that timely adjustment of affected transactions is not feasible due to the extraordinary nature of the situation, then the Exchange will nullify some<sup>5</sup> or all transactions arising out of the SME during the review period selected by the Exchange and other options exchanges.

The Goldman Letter requests that the Exchange modify the Proposed Rule so that the Exchange will nullify all affected trades that occur as part of an SME in all circumstances. In support of this request, the Goldman Letter argues that the handling of an SME, including the adjustment of transactions, pursuant to the Proposed Rule will inject "unnecessary delay and higher risk of residual economic harm to affected market participants." In contrast, the Goldman Letter argues, in the context of an SME all affected transactions should be immediately nullified.

The Exchange does not believe that amending the Proposal is appropriate at this time. The Exchange acknowledges the concern set forth in the Goldman Letter and, with this concern in mind, the Exchange has proposed to retain the ability to nullify some or all transactions if necessary based on the nature of the SME and an inability of the Exchange and other options exchanges to provide market participants with adjustments in a reasonable manner. If the Exchange is able to reasonably provide adjustments, however, 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.

As set forth in the Proposal, hedging transactions that are commonly engaged in by market participants necessitate adjustments rather than nullifications when possible to limit the potential negative economic impact to such participants. In particular, the Exchange believes that, when possible, the trades of liquidity providers should be adjusted as a result of an obvious error because liquidity providers typically engage in hedging activity and a nullification of their obvious error trades could have a significant negative impact upon such firms. This risk is magnified during an SME, particularly for liquidity providers that quote across a wide range of affected series. Thus, the Proposal seeks to balance 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 preserving the discretion to nullify some or all transactions in an SME.

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<sup>5</sup> As proposed, 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.

Conclusion

For the foregoing reasons, the Exchange respectfully requests the Commission approve the Proposal.

Very truly yours,



Anders W. Franzon  
VP, Associate General Counsel

cc: Mary Jo White, Chair  
Luis A. Aguilar, Commissioner  
Daniel M. Gallagher, Commissioner  
Kara M. Stein, Commissioner  
Michael S. Piwowar, Commissioner  
Stephen Luparello, Director, Division of Trading and Markets  
Gary Goldsholle, Deputy Director, Division of Trading and Markets  
Heather Seidel, Associate Director, Division of Trading and Markets  
David Shillman, Associate Director, Division of Trading and Markets  
David Hsu, Assistant Director, Division of Trading and Markets