SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–67756; File No. SR–BATS–2012–026]

Self-Regulatory Organizations; BATS Exchange, Inc.; Order Approving Proposed Rule Change, as Modified by Amendment No. 1, To Adopt a New Market Maker Peg Order Available to Exchange Market Makers

August 29, 2012.

I. Introduction

On June 26, 2012, 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 adopt a new Market Maker Peg Order to provide similar functionality as the automated functionality provided to market makers under Rule 11.8(e). The proposed rule change was published for comment in the **Federal Register** on July 16, 2012.[3] The Commission received no comment letters regarding the proposed rule change. This order approves the proposed rule change, as modified by Amendment No. 1.

II. Background

BATS is proposing to adopt a new Market Maker Peg Order to provide a similar functionality presently available to Exchange market makers under Rule 11.8(e).[4] BATS adopted Rule 11.8(e) as part of an effort to address issues uncovered by the aberrant trading that occurred on May 6, 2010.[5] According to the Exchange, the automated quote management functionality offered by these rules is designed to help Exchange market makers meet the enhanced market maker obligations adopted post May 6, 2010,[6] and avoid execution of market maker ''stub quotes'' in instances of aberrant trading.[7] As part of these obligations, BATS requires market makers for each stock in which they are registered to continuously maintain a two-sided quotation within a designated percentage of the National Best Bid and National Best Offer,[8] as appropriate. According to BATS, the market maker quoter functionality presents difficulties to market makers in meeting their obligations under Rule 15c3–5 under the Act (the ''Market Access Rule'') [9] and Regulation SHO.[10] Specifically, the current market maker quoter functionality offered to market makers reprices and ''refreshes'' a market maker's quote when it is executed against, without any action required by the market maker. When a market maker's quote is refreshed by the Exchange, however, the market maker has an obligation to ensure that the requirements of the Market Access Rule and Regulation SHO are met. To meet these obligations, a market maker must actively monitor the status of its quotes and ensure that the requirements of the Market Access Rule and Regulation SHO are being satisfied.

Market Maker Peg Order

In an effort to simplify market maker compliance with the requirements of the Market Access Rule and Regulation SHO, BATS proposes to adopt a new order type available only to Exchange market makers, which offers functionality similar to the market maker quoter functionality, but also allows a market maker to comply with the requirements of the Market Access Rule and Regulation SHO. Specifically, BATS proposes to replace the market maker quoter functionality with the Market Maker Peg Order. The Market Maker Peg Order would be a one-sided limit order and similar to other peg orders available to market participants in that the order is tied or ''pegged'' to a certain price,[11] but it would not be eligible for routing pursuant to Rule 11.13(a)(2) and would always be displayed. The Market Maker Peg Order would be limited to market makers and would have its price automatically set and adjusted, both upon entry and any time thereafter, in order to comply with the Exchange's rules regarding market maker quotation requirements and obligations.[12] It is expected that market makers will perform the necessary checks to comply with Regulation SHO, as discussed above, prior to entry of a Market Maker Peg Order. Upon entry and at any time the order exceeds either the ''Defined Limit'', as described in Rule 11.8(d)(2)(E), or moves a specified number of percentage points away from the Designated Percentage towards the then current National Best Bid or National Best Offer, the Market Maker Peg Order would be priced by the Exchange at the Designated Percentage [13] away from the then current National Best Bid and National Best Offer. Where there is no National

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 67381 (July 10, 2012), 77 FR 41829 (''Notice''). The Commission notes that on July 6, 2012, the Exchange submitted Amendment No. 1 to the proposed rule change to make certain amendments that, in part, clarified that it is expected that market makers will perform the necessary checks to comply with Regulation SHO prior to entry of a Market Maker Peg Order.

[4] BATS will continue to offer the present automated quote management functionality provided to market makers under Rule 11.8(e) for a period of 3 months after the implementation of the proposed Market Maker Peg Order. The purpose of this transition period, during which both the present automated quote management functionality under Rule 11.8(e) and the Market Maker Peg Order will operate concurrently, is to afford market makers with the opportunity to adequately test the new Market Maker Peg Order and migrate away from the present automated quote management functionality under Rule 11.8(e). Prior to the end of this three month period, BATS represents that it will submit a rule filing to retire the automated quote management functionality under Rule 11.8(e). *See* Notice, *supra* note 3 at 41829.

[5] Securities Exchange Act Release No. 63255 (November 5, 2010), 75 FR 69484 (November 12, 2010) (SR–BATS–2010–25).

[6] *Id.*

[7] For each issue in which a market maker is registered, the market maker quoter functionality optionally creates a quotation for display to comply with market making obligations. Compliant displayed quotations are thereafter allowed to rest and are not adjusted unless the relationship between the quotation and its related national best bid or national best offer, as appropriate, either: (a) Shrinks to a specified number of percentage points away from the Designated Percentage (as defined below) towards the then current national best bid or national best offer, which number of percentage points will be determined and published in a circular distributed to Members from time to time, or (b) expands to within 0.5% of the applicable percentage necessary to trigger an individual stock trading pause, whereupon such bid or offer will be cancelled and re-entered at the Designated Percentage away from the then current national best bid and national best offer, or if no national best bid or national best offer, at the Designated Percentage away from the last reported sale from the responsible single plan processor. Quotations independently entered by market makers are allowed to move freely towards the national best bid or national best offer, as appropriate, for potential execution. In the event of an execution against a quote generated pursuant to the market maker quoter functionality, the market maker's quote is refreshed on the executed side of the market at the applicable Designated Percentage away from the then national best bid (offer), or if no national best bid (offer), the last reported sale. *See* Rule 11.8(e).

[8] As defined by Regulation NMS Rule 600(b)(42). 17 CFR 242.600.

[9] *See* Notice, *supra* note 3 at 41830.

[10] 17 CFR 242.200 through 204.

[11] Rule 11.9(c)(8).

[12] The Market Maker Peg Order is one-sided so a market maker seeking to use Market Maker Peg Orders to comply with the Exchange's rules regarding market maker quotation requirements would need to submit both a bid and an offer using the order type.

[13] The ''Designated Percentage'' is the individual stock pause trigger percentage listed in Interpretations and Policies .01 to Rule 11.8, less either: (i) Two percentage points for securities that are included in the S&P 500® Index, Russell 1000® Index, and a pilot list of Exchange Traded Products and for all other NMS stocks with a price equal to or greater than $1 per share; or (ii) twenty percentage points for all NMS stocks with a price less than $1 per share that are not included in the S&P 500® Index, Russell 1000® Index, and a pilot list of Exchange Traded Products. *See* Rule 11.8(d)(2)(D).

Best Bid or National Best Offer, the Market Maker Peg Order would, by default, be priced at the Designated Percentage away from the last reported sale from the responsible single plan processor, unless instructed by the market maker upon entry to cancel or reject where there is no National Best Bid or National Best Offer. According to BATS, in the absence of a National Best Bid or National Best Offer and last reported sale, the order will be cancelled or rejected. Adjustment to the Designated Percentage is designed to avoid an execution against a Market Maker Peg Order that would initiate an individual stock trading pause. In the event of an execution against a Market Maker Peg Order that reduces the size of the Market Maker Peg Order below one round lot, the market maker would need to enter a new order, after performing the regulatory checks discussed above, to satisfy their obligations under Rule 11.8.[14] In the event that pricing the Market Maker Peg Order at the Designated Percentage away from the then current National Best Bid and National Best Offer, or, if no National Best Bid or National Best Offer, to the Designated Percentage away from the last reported sale from the responsible single plan processor would result in the order exceeding its limit price, the order will be cancelled or rejected.

BATS is also proposing to allow a market maker to designate an offset more aggressive (*i.e.,* smaller) than the Designated Percentage for any given Market Maker Peg Order. This functionality will allow a market maker to quote at price levels that are closer to the National Best Bid and National Best Offer if it elects to do so. To use this functionality, a market maker, upon entry, must designate the desired offset and a percentage away from the National Best Bid or National Best Offer at which the price of such bid or offer will be adjusted back to the desired offset (the ''Reprice Percentage'').[15] Thereafter,[16] a Market Maker Peg Order with a market maker-designated offset will have its price automatically adjusted to the market maker-designated offset from the National Best Bid or National Best Offer or last reported sale upon reaching the Reprice Percentage.[17] Identical to the behavior of Market Maker Peg Orders using the Defined Percentage and Defined Limit, in the absence of a National Best Bid or National Best Offer, Market Maker Peg Orders with a market maker-designated offset will, by default, have their price adjusted to the Market Maker-designated offset from the price of the last reported sale from the responsible single plan processor, or, if otherwise instructed by the Market Maker, will be cancelled or rejected. In the absence of a National Best Bid or National Best Offer and a last reported sale, Market Maker Peg Orders with a market maker-designated offset will be cancelled or rejected. In the event that pricing the Market Maker Peg Order at the market maker-designated offset away from the then current National Best Bid and National Best Offer or last reported sale would result in the order exceeding its limit price, the order will be cancelled or rejected.[18]

BATS claims that this order-based approach is superior in terms of the ease in complying with the requirements of the Market Access Rule and Regulation SHO while also providing similar quote adjusting functionality to its market makers.[19] BATS also states that market makers would have control of order origination, as required by the Market Access Rule, while also allowing market makers to make marking and locate determinations prior to order entry, as required by Regulation SHO. The Exchange claims that this will allow market makers to fully comply with the requirements of the Market Access Rule and Regulation SHO, as they would when placing any order, while also meeting their Exchange market making obligations.[20]

III. Discussion and Commission Findings

After careful review, 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.[21] Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[22] which requires, among other things, the rules of an exchange 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 finds that the proposed rule change also is designed to support the principles of Section 11A(a)(1)[23] of the Act in that it seeks to assure fair competition among brokers and dealers and among exchange markets.

The Commission finds that the Exchange's proposal is consistent with the Act because it provides a means through which market makers may meet their minimum quoting requirements, which may assist in the maintenance of fair and orderly markets, provide additional liquidity to the Exchange, and prevent excessive volatility. The Commission notes, however, that notwithstanding the availability of the Market Maker Peg Order functionality, the market maker remains responsible for meeting its obligations under Rule 11.8, including entering, monitoring, and re-submitting, as applicable, compliant quotations. At the same time, the Commission finds that the proposal is reasonably designed to assist market makers in complying with the regulatory requirements of the Market Access Rule and Regulation SHO. The Commission notes, however, that the Market Maker Peg Order, like the

[14] Rule 11.8 generally sets forth BATS's market maker requirements, which include quotation and pricing obligations.

[15] If a market maker wishes, it can designate a more aggressive bid while using the Defined Percentage and Defined Limit for its offer, or vice versa.

[16] In the absence of an offset designation and/or Reprice Percentage, a Market Maker Peg Order will default to using the Defined Percentage and Defined Limit, and the repricing process whereby, upon reaching the Defined Limit, the price of a Market Maker Peg Order bid or offer will be adjusted by the System to the Designated Percentage away from the then current National Best Bid or National Best Offer, or, if no National Best Bid or National Best Offer, to the Designated Percentage away from the last reported sale from the responsible single plan processor.

[17] Market Maker Peg Orders with a market maker-designated offset may be able to qualify as bona-fide market making for purposes of Regulation SHO, depending on the facts and circumstances. A market maker entering such an order must consider the factors set forth by the Commission in determining whether reliance on the exception from the ''locate'' requirement of Rule 203 for bona-fide market making is appropriate with respect to the particular Market Maker Peg Order and its designated offset. *See* 17 CFR 242.203(b)(1).

[18] The Market Maker Peg Order will be accepted during Regular Trading Hours and the Pre-Opening and After Hours Trading Sessions. The Pre-Opening Session means the time between 8 a.m. and 9:30 a.m. Eastern Time. The After Hours Trading Session means the time between 4 p.m. and 5 p.m. Eastern Time. By default, the Market Maker Peg Order will be priced at 9:30 a.m. and will only be executable during Regular Trading Hours, however, upon entry, a User may direct the Exchange to automatically price and execute a Market Maker Peg Order during the Pre-Opening Session and After Hours Trading Session (''Extended Hours Market Maker Peg Orders''). During the Pre-Opening Session and After Hours Trading Session, the wider Designated Percentage and Defined Limit associated with the 9:30 a.m.–9:45 a.m. and 3:35 p.m.–4 p.m. periods under Rule 11.8(e) will be applied to Extended Hours Market Maker Peg Orders for which the market maker has not designated an offset more aggressive than the Designated Percentage.

[19] *See* Notice, *supra* note 3 at 41831.

[20] *See id.*

[21] In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

[22] 15 U.S.C. 78f(b)(5).

[23] 15 U.S.C. 78k–1(a)(1).

current market maker quoter functionality, does not ensure that the market maker is satisfying the requirements of the Market Access Rule or Regulation SHO, including the satisfaction of the locate requirement of Rule 203(b)(1) or an exception thereto. The Commission also notes that, in the event a Market Maker Peg Order is executed against such that the Market Maker Peg Order is reduced in size to below one round lot, the market maker would need to perform the necessary regulatory checks pursuant to the Market Access Rule and Regulation SHO prior to entering a new Market Maker Peg Order.

The Commission also believes that providing Exchange market makers with a transition period will serve to minimize the potential market impact caused by the implementation of the Market Maker Peg Order. In addition, by allowing market makers to enter a Market Maker Peg Order that is priced more aggressively than the Designated Percentage, the proposed rules are reasonably designed to provide that quotations submitted by market makers to the Exchange, and displayed to market participants, bear some relationship to the prevailing market price.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[24] that the proposed rule change, as modified by Amendment No.1, (SR–BATS–2012–026) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[25]

Kevin M. O'Neill,

Deputy Secretary.

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[24] 15 U.S.C. 78s(b)(2).

[25] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–67753; File No. SR–Phlx–2012–78]

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Order Granting Approval of Proposed Rule Change Regarding Strike Price Intervals in the Short Term Options Program

August 29, 2012.

I. Introduction

On July 2, 2012, NASDAQ OMX PHLX LLC (''Phlx'' or ''Exchange'') 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 indicate that the interval between strike prices on short term options series (''STOs'') listed in accordance with its Short Term Option Series Program (''STO Program'') shall be $0.50 or greater where the strike price is less than $75 and $1 or greater where the strike price is between $75 and $150. The proposal would also provide that, during the expiration week of an option that is in the same class as an STO but has a longer expiration cycle (''Related non-STO'') the strike price interval for the STO and such Related non-STO shall be the same and that a Related non-STO shall be opened for trading in STO intervals in the same manner as the STO. The proposed rule change was published for comment in the **Federal Register** on July 20, 2012.[3] The Commission received one comment letter on the proposal.[4] On August 16, 2012, the Exchange filed a response to the CBOE Letter (''Phlx Response'').[5] This order approves the proposed rule change.

II. Description of the Proposal

The Exchange proposed to amend Phlx Rules 1012 (Series of Options Open for Trading) and 1101A (Terms of Options Contracts) to indicate that the interval between strike prices on STOs shall be $0.50 or greater where the strike price is less than $75 and $1 or greater where the strike price is between $75 and $150 (''STO Intervals''). The proposal would amend Phlx's rules to indicate that, during expiration week of a Related non-STO, the strike price intervals for the STO and Related non-STO shall be the same. Phlx also proposed to amend its rules to indicate that, during the week before the expiration week of the Related non-STO, such Related non-STO shall be opened for trading in the STO Intervals and in the same manner as the STO.

In the Notice, the Exchange stated that the principal reason for the proposed expansion is market demand for weekly options and continuing strong customer demand to use STOs to effectively execute hedging and trading strategies.[6] Conversely, Phlx contended that inadequately narrow STO intervals can impact trading and hedging opportunities.[7] Phlx also stated that listing Related non-STOs at the same strike prices intervals as STOs will ensure conformity and give investors and traders the ability to maximize trading and hedging opportunities and minimize associated costs.[8]

The Exchange stated that it has analyzed its capacity, and represented that it and the Options Price Reporting Authority (''OPRA'') have the necessary systems capacity to handle the potential additional traffic associated with trading in STOs at $0.50 or greater where the strike price is less than $75 and $1 or greater where the strike price is between $75 and $150. In addition, Phlx stated that it believes that the proposed rule change will not raise a capacity issue with its members.[9]

III. Discussion and Commission Findings

After careful review of the proposed rule change and the CBOE Letter, 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.[10] Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,[11] which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, 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 strikes a reasonable balance between the Exchange's desire to offer a wider array of investment opportunities and the

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 67446 (July 20, 2012), 77 FR 42780 (''Notice'').

[4] *See* letter from Jenny L. Klebes-Golding, Senior Attorney, Legal Division, Chicago Board Options Exchange, Incorporated (''CBOE''), to Elizabeth M. Murphy, Secretary, Commission, dated August 10, 2012 (''CBOE Letter''). CBOE sought, in part, further clarification on whether the current 30 series per-class limitation set forth in the STO Program would apply to the Related non-STOs when the STO strike price intervals are added in accordance with this proposal.

[5] In its response, Phlx confirmed that the 30 series limitation CBOE identified applies to STOs only and would not restrict the ability to open additional series of Related non-STOs in accordance with the proposed rule change. *See* Phlx Response at 2–3.

[6] *See* Notice, *supra* note 3 at 42781.

[7] *Id.* at 42782–42783.

[8] *Id.* at 42783.

[9] *Id.*

[10] In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[11] 15 U.S.C. 78f(b)(5).