April 21, 2010

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

RE: Concept Release on Equity Market Structure; Exchange Act Release No. 61358; File No. S7-02-10

Dear Ms. Murphy:

BATS Exchange, Inc. ("BATS") appreciates the opportunity to comment on the above referenced Concept Release on Equity Market Structure ("Concept Release"). BATS is the third largest registered exchange in the United States, executing on its single book approximately 9 -11% of the daily equity market volume. BATS recently launched an equity options market in the United States, and also operates a successful multi-lateral trading facility in Europe. BATS is, however, a recent entrant into the market, launching from a storefront in Kansas City as an alternative trading system ("ATS") in 2006, and registering as an exchange in 2008.

BATS was created at a time when consolidation in the marketplace had reverted the industry to a potentially non-competitive duopoly of dominant exchanges – the NYSE and NASDAQ. BATS' mission was and continues to be to make markets better through competition. Our success in this endeavor has depended on the operation of a highly proficient and resilient technology platform, and the provision of innovative products, high quality customer service, and simple pricing. During our brief history, we leveraged many of the market structure initiatives currently under consideration in the Concept Release to grow over a short period of time from no trading volume as a new entrant in early 2006 to 10% of the total volume by the time we registered as an exchange in 2008. Having navigated under the existing market structure, we welcome the opportunity to provide our input on these important topics.

I. Background

In 1975, Congress directed the Securities and Exchange Commission ("Commission") to facilitate the development of a national market system for securities designed to set forth a framework in which competing markets would be linked together in ways that would produce the best prices and efficient executions ("1975 Amendments").[1] Since 1975, the Commission has taken several steps toward realizing Congress' directive, but the greatest changes have arguably

1 See 15 U.S.C. 78k-1.

come about over the past decade and a half. During this period, the Commission has adopted rules that have had a profound impact on the evolution of the equities market, including the Order Handling Rules in 1996,[2] which integrated ECNs into the national market system by requiring certain ECN quotes to be reflected in the public markets; Regulation ATS in 1998,[3] which established a regulatory framework for ATSs and required those ATSs that displayed quotes to subscribers to include those quotes in the public markets after reaching certain volume thresholds; and importantly, Regulation NMS in 2005,[4] which, among other things, enhanced inter-market price protection by establishing a general prohibition on trading at a price inferior to another trading center's immediately and automatically accessible best bid or offer in a security.

In combination with technological enhancements over this same time period, the above-mentioned regulatory initiatives have revolutionized equity trading in the United States. Barriers to entry into the trade execution space have fallen, allowing innovative ATSs to emerge and compete against established and dominant exchanges. Competition has resulted in a dispersion of liquidity across multiple but interconnected platforms. As a result, the cost of trade execution has dramatically declined. Explicit transaction fees have fallen and trading spreads have narrowed. Technological innovation has led to the development of trade execution platforms that can process order messages in sub-millisecond time frames, dramatically reducing the risk associated with placing an order into the market. The traditional notion of manual market makers earning large spreads has been displaced by a new generation of automated market makers which use computer algorithms to post bids and offers in the market, competing against one another for effective spreads of fractions of a penny per share. These changes in turn have allowed more capital to be deployed into the equity markets, resulting in greater liquidity, and better execution prices for retail and institutional investors, and lower trading costs.[5]

It is against this backdrop, one which appears to have made great strides in realizing Congress' intent in the 1975 Amendments, that the Commission has published its broad, probing Concept Release to analyze the effectiveness, fairness, and efficiency of the equity markets. The Commission's Release was published in the aftermath of a financial crisis that plagued economies globally, seemingly overnight decimating corporate share prices, and creating a storm of subsequent outrage and criticism by some who believe the equity market structure may bear some of the blame for the global crash in asset values.

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2 Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996).

3 Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998).

4 Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

5 See Jones and Sirri, *Examining the Main Street Benefits of our Modern Financial Markets*, U.S. Chamber of Commerce, Center for Capital Markets Competitiveness (2010) (finding that "[o]ver the past 20 years or so, technology and competition have dramatically reduced the cost of investing . . ., [making] our markets fairer than ever before, giving average investors access to the best possible price when they buy and sell"); see also Angel, Harris, and Spatt, *Equity Trading in the 21st Century* (February 23, 2010) (finding that "[v]irtually every dimension of U.S. equity market quality is now better than ever" – execution speeds have increased, effective spreads have narrowed, commissions have fallen, and market depth has increased).

BATS welcomes the scrutiny and believes there likely are regulatory initiatives the Commission could undertake to further optimize the equity markets. However, BATS urges the Commission to tread carefully in its analysis and to not be swayed by those who would counsel the Commission to start from the proposition that the equity markets are fundamentally flawed. BATS urges the Commission to evaluate the equity markets through an objective lens, and to take note of the tremendous gains over the past decade in transparency, fairness, competition, reduced costs, and efficiency. BATS does not believe the United States equity market structure caused or facilitated the global decline in asset values, but rather provided the foundation for tremendous resiliency during the crisis. Unlike markets for other asset classes, the equity markets remained open, liquid, transparent and efficient day in and day out during one of the most stressful periods in the history of our capital markets. The Commission should not ignore that its regulatory initiatives over recent years in combination with technological innovation made that performance possible.

II. Trading Strategies

The Concept Release contains several questions related to the trading strategies of proprietary trading firms, including questions designed to identify what trading strategies are employed by such firms, to ascertain whether particular strategies reflect a competitive response to particular market structure components, and to determine whether particular strategies benefit or harm the interests of long term investors.

BATS believes the Commission should recognize that trading strategies are numerous and diverse and any attempt to qualify otherwise legal strategies as morally good or bad is unlikely to reach a productive outcome. Importantly, even trying to identify particular trading conduct as falling into a specific category of strategy is often nearly impossible. And to what end in the first instance? Absent manipulation and fraud, such as wash and pre-arranged trading, trading after spreading false rumors, and insider trading, BATS believes market forces should dictate which trading strategies survive and which go by the wayside. BATS also believes that trading strategies will always evolve to reflect the particular market structure in place at any given point in time; hence, to the extent there may be some strategies that depend on certain aspects of the current market structure, BATS does not believe the Commission could or should base market structure decisions solely on that fact. Any such efforts would likely lead the Commission to being engaged in the policy-making equivalent of "whack-a-mole" and would over time do no more than to continually impose costs on the industry of adapting to new rules and regulations for little discernable benefit.

The Concept Release specifically questions the impact of liquidity rebates paid by market centers to attract members to post liquidity on their books. In particular, the Concept Release asks whether such rebates are fair or unfair to long term investors, and whether there are any risk-free trading strategies driven solely by the ability to recoup a rebate that offer little or no utility to the market. BATS does not believe there are risk-free trading strategies that are driven solely by the ability to recoup a rebate. The mere posting of an order into the marketplace, under any circumstances poses position and directional risks to the trading participant. BATS believes that on the whole, payment of a rebate to attract liquidity benefits the market overall. Market makers factor that rebate into their quoted prices, enabling them to post tighter markets, which in turn benefits long term investors who receive better prices when they enter the market. BATS would contrast the payment of a transparent, rule-based rebate, which is available on exactly the same terms to all market participants, with the historical practice of payment for order flow which is opaque, subject to little effective regulatory oversight, and which only benefits certain market participants.

BATS believes that the appropriate focus of the Commission and other regulators should be on market surveillance to detect potential abuses. There will always be intra-market and inter-market opportunities to engage in fraud, regardless of rules adopted to prevent fraudulent activity. That fact, however, illustrates the need for regulators to be innovative in their tactics to detect fraud. As a self-regulatory organization, BATS takes these responsibilities seriously and we devote substantial resources to fraud detection and investigation through investment in staff, technology, and our regulatory services contract with FINRA. BATS understands the Commission is taking steps towards the development of a potential real-time inter-market consolidated equity audit trail that would greatly enhance the ability to detect such activity. BATS supports this initiative and believes the Commission should continue to direct resources to enhancing fraud detection tools and enforcement capabilities to reduce fraudulent behavior.

III. Co-Location

The Concept Release focuses in many areas on the importance speed plays in the marketplace. As part of this focus, the Concept Release raises several questions around the practice of co-location. For many market participants, the ability to access a market center with the lowest possible latency is an important component to their trading strategy. For example, automated market makers require low latency because it enables them to gain greater control over the risks associated with placing an order into the marketplace. The ability to quickly enter and/or modify an order as market conditions change enables market makers to more efficiently deploy capital which translates again into tighter spreads and more size quoted in the market. Similarly, professional traders who are not engaged in market making also benefit from co-location by, for example, being able to more quickly act on a pricing inefficiency or anomaly in the market. Again, this benefits the market as a whole by ensuring that at any given point in time the price of a security is reflective of fair value.

The Commission rightfully notes in the Concept Release that co-location services offered by registered exchanges ought to be (and are) subject to the Exchange Act. In that regard, BATS supports efforts by the Commission to ensure that co-location services not be offered on unfairly discriminatory terms, and that the fees charged for those services be equitably allocated and reasonable. The Concept Release requests comment on many issues in this regard, including whether certain firms with the resources and sophistication to utilize co-location have an unfair advantage over other market participants, including long-term investors.

A. Co-Location Advantages

BATS believes that there will always be firms that have better resources at their disposal than other firms, traders, or investors to provide them an advantage in trading. The advantage could come from better research, better technology, or smarter human capital in general. Attempting to regulate these advantages to level the playing field to the lowest common denominator would do far more harm than good. Of course, as it relates to services offered by an exchange, BATS fully believes that such services should be offered on a non-discriminatory basis, which in BATS' view means on the same essential terms to all forms of market participants. That does not mean that all firms necessarily must have the resources or sophistication to co-locate. Exchanges offer many services, including complex order types and historical and real-time order and trade data, and not all firms have the resources or sophistication to avail themselves of those services.

The Commission itself has never equated fair access with mandatory equal access. Consider, for example, the use of volume tiered pricing in place at several market centers whereby firms that execute high levels of share volume qualify for the most favorable pricing. Small firms can be effectively denied access to this more favorable pricing, yet because the tiers are offered to all who can qualify on an otherwise non-discriminatory basis, the Commission has routinely found them to be consistent with the Exchange Act, including the anti-discrimination provisions of Rule 610 of Regulation NMS: "[o]ther types of differential fees, however, would not violate the anti-discrimination standard of Rule 610. Fees with volume-based discounts or fees that are reasonably based on the cost of providing a particular service will be permitted."[6]

While BATS does not believe the Commission should require exchanges to ensure that all market participants actually do co-locate, it would be wrong to conclude as some have suggested that only a certain segment of proprietary trading firms are able to avail themselves of that service. Many broker-dealers serving a diverse clientele including long term retail and institutional investors are co-located to the exchanges. There is, however, an important distinction in the needs and trading habits of professional traders and long term investors, and BATS believes a lack of appreciation for this distinction has injected some confusion into the debate over the fairness of co-location. For professional traders, co-location offers them the quickest possible means in which to act on a trading decision to access the market. While this is similarly true for long term investors trading through a co-located broker, it is axiomatic that a long term investor's <u>decision</u> to access the market is a human one that cannot be made at the physical point of a co-located computer. It is, therefore, true that professional firms and traders making automated trading decisions from a co-located computer will be able to act on that decision faster than a long term investor can act from a remote location; however, professional traders have always enjoyed such time and place advantages and co-location offers nothing new or particularly interesting in that regard.

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6 Exchange Act Release No. 51808 at p. 170.

Similarly, firms that co-locate often take direct market data feeds from the exchanges and ATSs to which they are co-located. In doing so, firms are able to obtain a view of the market more quickly than those market participants that are relying on the consolidated tape to receive this information. BATS believes this development reflects again a time and place advantage that is not unique to this market structure or point in time. Historically, such an advantage was solely within the province of traders physically located on the floor of manual exchanges. While the consolidated tape was a useful reference tool, one often needed the services of a floor broker to ascertain the true market for a security at any given point in time. Today, in contrast, while such time and place advantages continue to exist, they are less significant than they were in the past, and access to those advantages has been democratized unlike at any point in history. They are less significant because the quality and timeliness of the information in the consolidated tape has improved dramatically – post Regulation NMS, which created the concept of a "protected quote", BATS believes more orders are reflected in the consolidated tape, and the latency associated with collecting that data and transmitting it has fallen significantly.[7] Access has been democratized because, and as previously stated, a wide range of firms, including proprietary traders, institutional investors, and retail firms co-locate to exchanges and ATSs. In addition, market data vendors take these direct data feeds and redistribute them throughout the industry.

So, do long term investors actually benefit from firms that access markets and market data through co-location? BATS believes they do. For example, a long term investor engaged in on-line trading through a co-located broker will receive an ultra fast execution after clicking the mouse to trade – perhaps as quickly as within one second. When that long term investor's order reaches the market, that investor can be certain that at that instant the current price reflects the market's collective judgment of the security's fair value. Why is this? Because the professional traders who are making markets and exercising various trading strategies through co-located computers are at each instant pushing the security to its fair value.

BATS believes some would seek to pit the long term investor against the professional trader in the mistaken belief that they are engaged in battle against one another and the long term investor has arrived to the gun fight with a putty knife. Nothing could be further from the truth. While certain professional traders are in competition with one another, not every trade represents a zero sum game and that is especially true as it relates to professional traders interacting with long term investors. Professional traders are trading in time horizons much different from the long term investor, and they may be profiting (or not) from positions taken across multiple correlated instruments.

Similarly, BATS believes some would seek to argue that co-location employed by certain professional traders gives them the ability to front run an order from a long term investor. As the argument has been described, when a long term investor makes a human decision to trade and enters an order into the marketplace, the professional trader's co-located computer "sees" that order before it reaches the exchange or before it is executed and then leaps into action sending an

[7] Currently, the average latencies for the Consolidated Tape (both quotes and trades) range between 5 and 10 milliseconds. This compares with 20-50 milliseconds less than two years ago.

order in front of it to buy or sell the stock the long term investor was seeking to buy or sell. This would be unfair and would warrant regulatory action if it were happening.[8] In fact, however, at BATS that long term investor's order is not seen by another firm's co-located computer at all. There is no ability for one firm to scan orders on their way to the exchange or to get in front of any order that has arrived to the exchange. In addition, and as previously stated, widely available market data feeds provide notice to members of new orders received by the BATS Exchange at the same time. Other major exchanges generally operate in a similar fashion to BATS, such that notifications of new orders are made to all members simultaneously.

For these reasons, BATS would resist efforts suggested by the Concept Release that would seek to "normalize" differential trading advantages to the lowest common denominator by, for example, batch processing orders every second, or imposing artificial delays on the transmission of market data. BATS believes such efforts would be counterproductive, serving only to stifle innovation, reduce available liquidity, and consequently increase explicit and implicit transaction costs. Similarly, BATS would resist efforts suggested by the Concept Release that the Commission could implement specific requirements to ensure that all market participants that purchase co-location services are guaranteed equal latency. As noted in the Concept Release, "latency can arise from a variety of sources, such as cable length and capacity, processing capabilities, and queuing." We would also add to this list copper and optical cabling (including quality, mode, power, and attenuation of fiber optics) and network equipment (including vendor, type, quality and speed), all of which are variable in nature and may change for the better or worse over time. BATS does not believe it is practicable to impose regulatory measures that would guarantee equal latency across all market participants.

BATS is supportive of a regulatory initiative related to latency transparency. For example, BATS would support periodic public disclosure of average and mean latencies, as well as the full distribution curve,[9] in addition to private reports directly to individual market participants of their specific latencies. Such transparency would enable competitive forces to come to bear on the issue rather than inefficient regulatory constraints that would likely be ineffective and have unintended consequences.

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8 BATS is mindful that their do exist some order handling strategies in the equities and options markets through which under certain circumstances a broker can elect to expose an order that is marketable against a quote displayed elsewhere exclusively to an exchange's or ATS's members and subscribers for potential execution prior to routing the order to the other destination for an execution against the displayed quote. These so-called "Flash" orders could present a front-running opportunity, which makes it incumbent on market centers offering such functionality to be diligent in conducting cross-market market surveillance. BATS also notes the Commission has proposed a ban on such order handling functionality in the equity and option markets. See Exchange Act Release No. 34-60684 (September 18, 2009); 74 FR 48632 (September 23, 2009).

9 BATS does not support public disclosure of the lowest latency among a market participant's members. BATS does not believe that data point is useful because both its amount and the firm experiencing it changes frequently based on several variables. BATS believes the average, mean, and the full distribution curve provide more meaningful latency information.

B. Affirmative and Negative Obligations

The Concept Release requests comment on whether co-location participants should be subject to affirmative or negative obligations, or whether the wide availability of co-location services distinguishes it from specialist advantages. BATS believes the availability of co-location services to retail, institutional, and proprietary trading firms reflects a significant distinction from traditional specialist advantages. As previously stated, while co-location presents some time and place advantages, BATS does not believe those advantages are as significant today as those traditionally available to specialists on the floor of a dominant exchange and unlike past time and place advantages, co-location is available to all firms. BATS believes there may be competitive drivers and/or market quality reasons for an exchange to adopt certain affirmative or negative obligations in certain instances and for certain categories of participants (registered market makers, for instance), regardless of whether those participants elect to co-locate any of their systems with the exchange. However, BATS believes the Commission should refrain from imposing such requirements through regulatory fiat and instead leave it to competitive forces, within the confines of the Exchange Act, to determine their appropriateness and structure.

C. Third-Party Co-Location Providers

The Concept Release also requests comment in connection with third parties that offer co-location to an exchange. BATS, for example, leases space for its trading system from a third party data site provider. BATS does not separately lease space for firms to co-locate; any firm wishing to co-locate to BATS must separately lease space from that third party or another third party with space in the data center. In other words, BATS is not involved in setting the fees for co-location and receives no part of the revenues received by a third party. Currently, because BATS does not involve itself in the co-location service offered by these third parties, the rates charged by those parties are not subject to the Exchange Act. We would note that because there is more than one third party offering co-location space to BATS, there are competitive forces that facilitate more efficient pricing. In fact, BATS understands that the rates charged by these third parties are generally less than charges levied by exchanges who own their own data sites or co-location space, which BATS believes to be the product of natural competitive forces working to the benefit of market participants. However, the rates charged by third party co-location providers are not transparent or subject to regulatory approval.

The Concept Release asks whether under a third party arrangement, and given the nexus between the service offered and access to an exchange, the third party should be considered a “facility” of the exchange or whether the exchange should obtain contractual commitments from the third party to provide co-location services on terms consistent with the Exchange Act. As previously mentioned, BATS supports Commission efforts to ensure that co-location services are provided on a fair and equitable basis and to that end could be supportive of a regulatory initiative relative to third party co-location service providers. BATS does not, however, believe it sensible to deem such a third party to be a facility of the exchange. BATS understands such providers to offer a wide-range of services separate and apart from exchange co-location and that they may derive a relatively small share of their revenues from co-location services. As such, BATS believes deeming a third party co-location provider to be a facility of the exchange, thus subjecting that third party's activities to the full requirements of the Exchange Act, would impose a burden on that third party not commensurate with the benefit sought to be achieved.

BATS may support a requirement that exchanges contractually ensure that co-location services offered by a third party comply with the Exchange Act. However, BATS stresses again that the services offered by third-party co-location providers are subject to competitive pressure not present with respect to exchange-owned data sites. We believe this provides a competitive check on the potential abuse of market power by an exchange not present with respect to exchange-owned data sites. Accordingly, BATS believes the Commission should carefully evaluate the rates charged under exchange-owned arrangements versus the competitive rates charged by third-party co-location providers in assessing the reasonableness of the former under the Exchange Act, and should carefully craft any regulatory initiative in this area to ensure that the benefits of this competitive check remain in place.

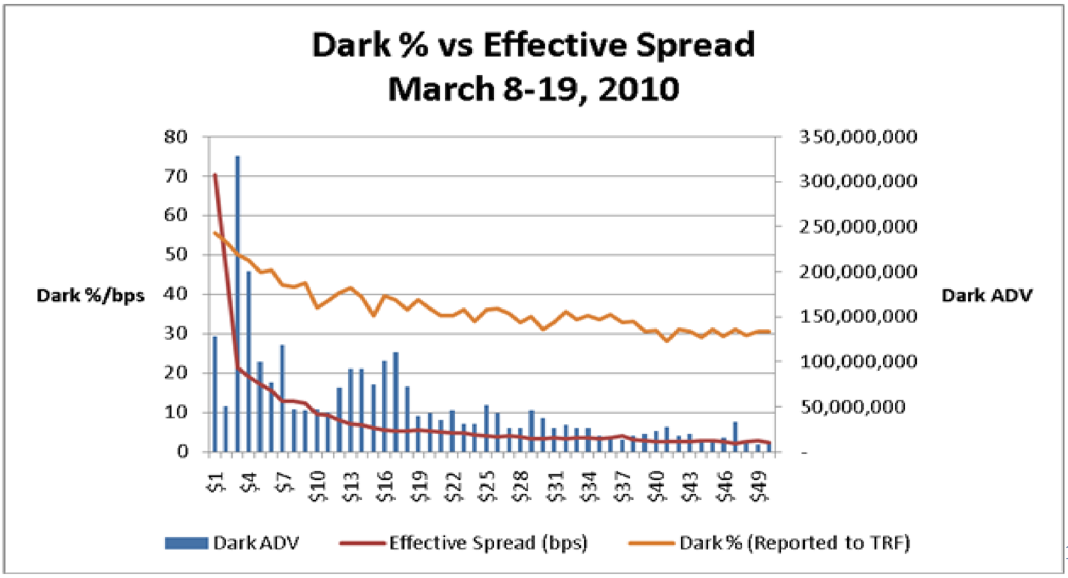
IV. Undisplayed Liquidity and Sub-Penny Quoting

The Concept Release requests comment on numerous aspects of undisplayed liquidity, which generally refers to executions reflecting internalized order flow or occurring on dark pools (collectively, trading in "dark venues"). In particular, the Concept Release questions whether the level of trading in dark venues has increased to the point that it detrimentally impacts the public price discovery process. If so, the Concept Release questions whether the Commission should consider adopting a "trade-at" rule that would prohibit any trading center from executing a trade at the price of the NBBO unless the trading center was publicly quoting that price at the time it received the incoming contra-side order. Under such a rule, a trading center that was not publicly quoting at the NBBO would be required to either execute the order with significant price improvement (such as the minimum allowable quoting increment) or route ISOs to the full displayed size of NBBO quotations and execute the balance of the order at the NBBO price. The net effect of such an initiative would likely be to encourage more orders to be displayed in the public markets, thereby enhancing the public price discovery process.

BATS believes there has been an increase in trading in dark venues, and BATS believes that increase has been most evident in certain highly liquid, low-priced securities. As explained below, BATS believes the cause for this development relates to the Commission's imposition of a minimum price variation ("MPV") of one cent, which in lower priced securities can result in publicly displayed quotes that are artificially wide. BATS believes that it is this artificially wide MPV, not trading in dark venues per se, that is detrimentally impacting the public price discovery process. Consequently, we believe the Commission should focus attention on the impact of its policy decisions related to tick sizes.[10]

[10] BATS does not support the implementation of a "trade at" rule as an alternate solution. While such a rule would likely have the effect of moving more orders to the public markets for execution, a trade-at rule does not address the fundamental problem of current constraints on public quote competition. In addition, if dark venues were required to execute orders with price improvement over the NBBO equal to $0.01 while

Currently the MPV for securities trading at or above $1.00 is one cent. The basis point spread between ticks in a one cent spread is much larger in a security trading at $3.00 than it is in a security trading at $30.00. In recognition of this fact, the Concept Release asks whether the larger basis point spread in lower priced stocks resulting from the one cent MPV leads to greater trading in dark venues. BATS believes it does. According to BATS' analysis, the overall volume of trading in dark venues is disproportionately higher in lower priced securities and the effective spread paid by investors on those transactions is similarly disproportionately high. The following graph mapping the price of the security against the basis point effective spread and percentage of volume occurring in dark venues is illustrative:



[11]

As can be seen from the chart, both the percentage of dark venue volume and the effective spread in basis points are disproportionately high for lower priced securities and only begin to normalize at securities priced somewhere above $20. It should be noted that at $20 the minimum price variation on one cent is equal to 5bps. The chart above shows that as the price increases above $20, the effective spread remains at approximately 5bps of the price of the security. This indicates that up to $20 the effective spread is being held artificially wide while after $20 competitive forces are allowed to determine the optimal effective spread, rather than the minimum price variation of one cent.

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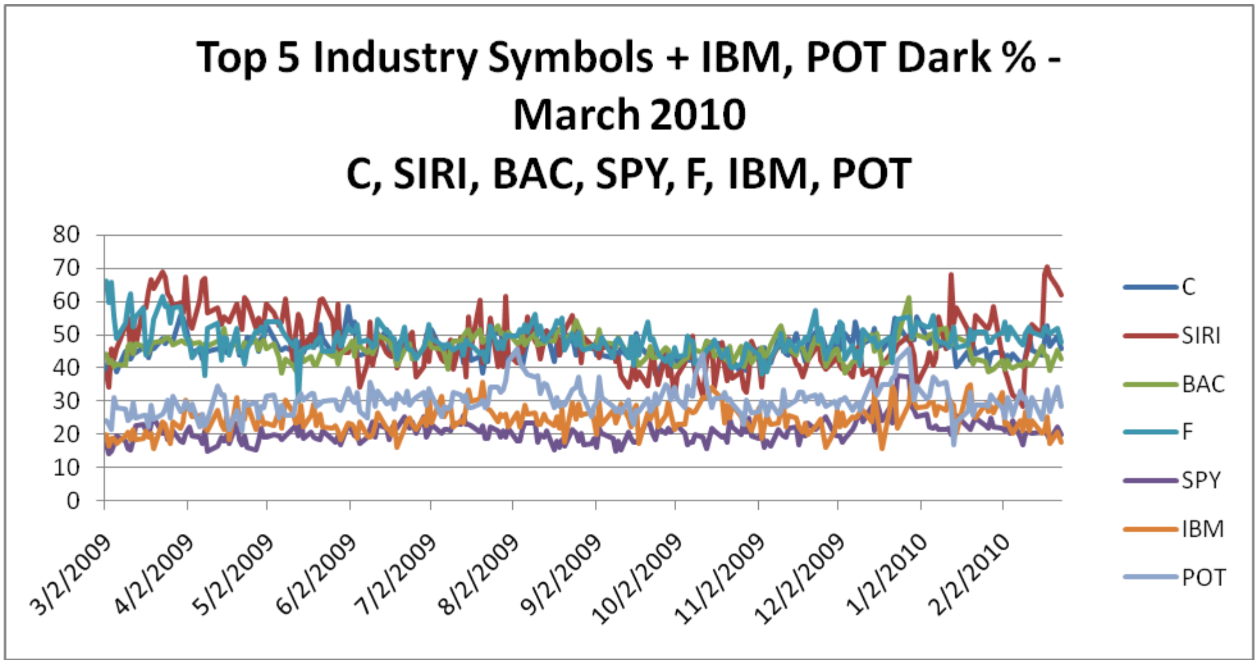
public markets quoting at the NBBO could execute orders at the midpoint of a $0.01 quoted spread (through the use of commonly available mid-point orders), dark venues would be unfairly detrimentally impacted. For these reasons, BATS believes the optimal solution requires narrowing the MPV for public quoting.

[11] The chart represents volume reported to a trade reporting facility ("TRF"), which BATS believes to be a reasonable approximation of dark venue volume. We were, however, unable to account for other non-dark venue volume from ECNs that are also reported to a TRF.

Similarly illustrative is the following chart that maps over the past year the percentage of dark venue market share in seven active securities including the top 5 most active securities (from March 2010):



Each of the five most active securities, with the exception of SPY, traded over this time period in price ranges of approximately $0.06 to $18.00. SPY, in contrast, traded in a range of approximately $72.00 to $113.00. To address any distinction in trading characteristics associated with the fact that SPY is an ETF while the other top volume securities are corporate issues, the chart also includes IBM and POT, which are the two most active corporate issues with an average close between $100 and $130 during March 2010. As can be seen from the chart above, the percentage of trading in dark venues is disproportionately high in the 4 most active securities trading at prices below $20.00.

BATS believes the reason for these trends relates directly to the inability of market participants to publicly quote lower priced securities in an MPV below one cent. Introducing finer MPVs would allow competitive market forces to reflect a better approximation of a stock's value. Bids and offers would narrow inward, closer to the perceived fair value. The more efficient providers of liquidity would likely take the risk to improve the displayed spread beyond what's available with today's one cent MPV. The disproportionate profit opportunities would likely come under pressure and begin to evaporate as the opportunity for competition incented trading participants to reflect a bid offer spread that more closely approximates the true value of the underlying security. Investors would subsequently receive better prices than they currently receive today.[12]

Accordingly, BATS would support an initiative by the Commission to introduce finer MPVs for securities priced between $1.00 and $20.00. BATS in fact believes the Commission should consider implementing a 3-month pilot program in a limited number of securities that consists of the following elements:

- An MPV for securities included in the pilot program of ½ cent.
- The inclusion in the pilot program of a selection of securities chosen across a range of price points from $1.00 to $20.00 and a range of trading volumes to measure the impact of a finer increment.
- Price protection of the ½ cent MPV under Rule 611 of Regulation NMS.
- Optional participation in the pilot program by market participants. That is, market participants would not be required to accept orders or publish quotes at the pilot program's ½ cent MPV. However, market participants could not trade through nor lock or cross an away market's better priced ½ cent protected quote.
- No change to the access fee cap of Rule 610 of Regulation NMS for securities included in the pilot program.
- Monthly reports to the Commission of the percentage of trading in these securities reported to the TRF and the effective spread.

At the conclusion of the pilot program, and depending on the results, we would envision requesting the Commission to make the pilot program permanent for more, if not all, securities trading between $1 and $20 and possibly some highly-liquid securities above $20.

[12] The thesis proposed here may be influenced by more than just the price range of securities. Other factors that may contribute to the appropriateness of finer MPVs include daily average volume (i.e. more liquid securities vs less liquid securities) as well as the nature of the security itself. For example, finer tick increments may be more appropriate for ETF securities because of the deterministic nature of their price resulting from the underlying formula of the securities that make up the ETF. In fact, for this reason it may be the case that finer MPVs are appropriate for ETF securities regardless of the price range of the ETF. On the other hand, for corporate issuer securities, finer MPVs may only be appropriate for securities that are relatively low-priced.

V. Alternative Trading Systems

When the Commission adopted Regulation ATS in 1998, it did so in the context of seeking "the benefits of both market centralization – deep, liquid markets – and competition." At the time, registered exchanges were linked together through the intermarket trading system, which contained some ostensible intermarket trade through protection. ATSs had remained largely outside this national market system, and as their volumes had grown, collectively they represented a significant component of the equities markets. The Commission was concerned that private, relatively unregulated markets could develop and had in fact developed on some of these ATSs that detrimentally effected the public price discovery process.

Recognizing the important competitive role presented by ATSs in terms of low barriers to entry and innovation, the Commission took a measured approach in Regulation ATS of "adopt[ing]" a regulatory framework that addresses its concern about [ATSs] without jeopardizing the commercial viability of these markets." Under Regulation ATS, therefore, ATSs fit within the statutory definition of an "exchange" but are exempt from registering as such (and, hence, exempt from taking on exchange regulatory obligations) so long as they register as a broker-dealer and meet certain other requirements, including the following:

- an ATS with less than 5% of the volume in any given security is required merely to file certain information with the Commission and maintain certain records;

- an ATS with greater than 5% of the volume in any given security is required to integrate its best priced quotations into the national market system if it publishes its quotes to any other person; and

- an ATS with 5% or more of the volume in any given security is required to meet fair access standards akin to that of a registered exchange – namely it must grant or deny access based on objective standards established and applied in a non-discriminatory manner.

The Concept Release raises several questions related to the functioning of Regulation ATS in today's marketplace, including whether the current fair access threshold at 5% is too high. In addition, the Concept Release questions whether ATSs carry their fair share of the regulatory burden in connection with the trading activity that occurs on their marketplaces. Some have suggested that ATSs should be required to bear the full weight of regulatory obligations currently imposed on exchanges.

BATS has a unique perspective on these questions, having launched as an ATS in 2006 at a time when industry consolidation had resulted in an entrenched exchange duopoly. The Regulation ATS framework provided BATS the means to initiate operations with no trading volume, and yet successfully compete against entrenched exchanges by offering innovative products, services, and pricing. Our success would be very difficult if not impossible to replicate under a framework that would impose the full weight of registered exchange regulatory obligations on a new ATS, and BATS suspects that mere fact may be the impetus for some to suggest that ATSs should carry greater regulatory responsibilities. Importantly, as BATS grew its market share, we determined that it was appropriate to register as an exchange and we did so in 2008. As a registered exchange with significant market volume, BATS is able to continue to drive efficiencies into the marketplace while bearing the regulatory burden associated with being an exchange. We could not have done this when our executed volume reflected a much smaller percentage of the marketplace.

Accordingly, BATS urges the Commission to proceed cautiously in analyzing any changes to the regulatory framework around ATSs. BATS believes that there may be an opportunity to optimize the regulatory framework to better balance regulatory responsibility with the volume associated with any ATS; for example, by gradually imposing greater regulatory obligations on an ATS as it increases its share volume – including fair access obligations, transparency, market surveillance, and perhaps an exchange-like rule filing requirement. From a regulatory standpoint, we should not treat an ATS with 0.05% market share as equivalent to an ATS with 3% market share. And, BATS would agree that at perhaps 5% market share an ATS has become significant enough and matured enough that it has the characteristics of an exchange. BATS would note that Rule 3a1-1(b) under the Exchange Act already contemplates the Commission's ability to compel an ATS to register as an exchange.

Accordingly, BATS does not believe the Commission should require all ATSs to take on additional regulatory responsibilities and obligations; however, BATS would support some modifications to Regulation ATS that would gradually impose such responsibilities and obligations as an ATS matures and gains market share. BATS' ability to exist and compete from 2006-2008 leveraged the measured approach taken in Regulation ATS. We believe the competition we injected into the marketplace has made the markets better, and we believe those coming behind us will continue to do the same – we have no desire to pull up the draw bridge now that we are a registered exchange nor do we think market structure would benefit from such an initiative.

VI. Odd-Lots

The Concept Release takes note of the volume of odd-lot trading activity in the marketplace, currently around 4% of overall market activity and asks whether market participants have an incentive to strategically trade in odd-lots to circumvent the consolidated tape, and whether odd-lot transactions should be included in the consolidated tape. BATS agrees that the volume of odd-lots appears high. And, while BATS does not know whether traders are using odd-lots to circumvent the consolidated tape, one could conceive of incentives do so, such as seeking to hide a large order in the marketplace or to avoid trade through prohibitions of Regulation NMS that do not apply to odd-lots. In any event, historically, when average trade sizes were 800 shares or more, the informational value associated with an odd-lot transaction was minimal. Today, however, as average trade sizes have fallen below 200 shares, the informational value associated with odd-lot transactions has risen and begins to approximate the informational value found in round and mixed lot transactions. Accordingly, BATS would be supportive of a regulatory initiative that would require odd-lot transactions to be reported to the tape. At 4% of the overall market volume, BATS believes that the lack of transparency into these executions is depriving the marketplace of material information.

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BATS appreciates the opportunity to comment on the Commission's Concept Release. Please feel free to contact me if you have any questions in connection with matter.

Sincerely,

Eric J. Swanson
SVP & General Counsel

Cc: The Hon. Mary L. Schapiro, Chairman
The Hon. Kathleen L. Casey, Commissioner
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
Robert W. Cook, Director, Division of Trading and Markets
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