March 21, 2010

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

RE: Risk Management Controls for Brokers or Dealers with Market Access; Exchange Act Release No. 61379; File No. S7-03-10

Ms. Murphy:

BATS Exchange, Inc. ("BATS") appreciates the opportunity to comment on the above referenced proposal to adopt rules that would require brokers or dealers with access to trading directly on an exchange or alternative trading system ("ATS"), including those providing sponsored or direct market access to customers or other persons, to implement risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of this business activity ("the Proposal"). BATS generally supports the efforts of the Securities and Exchange Commission ("SEC" or "Commission") to enhance risk controls to prevent the introduction of erroneous orders into the marketplace and preserve the integrity of trading on the securities markets and the stability of the financial system.

For the reasons discussed below, however, BATS believes the instant proposal is too far reaching in its scope and if implemented in its current form will have the unintended consequence of dramatically increasing trading friction and, hence, trading costs, which will in turn reduce available liquidity with little added benefit towards enhancing risk controls and preserving the integrity of the financial system.

Proposed Rule 15c3-5 would require a broker or dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through the use of its market participant identifier ("MPID") or otherwise, to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks, such as legal and operational risks related to market access. The proposed rule requires specific risk management controls and supervisory procedures, including controls that are reasonably designed to:

- Prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and the broker-dealer and, where appropriate, more finely-tuned by sector, security, or otherwise by rejecting orders if such orders would exceed the applicable credit or capital thresholds.

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- Prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order by order basis over a short period of time, or that indicate duplicative orders.

- Prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis.

- Prevent the entry of orders for securities for a broker or dealer, customer, or other person if such person is restricted from trading those securities.

- Restrict access to trading systems and technology that provide market access to permit access only to persons and accounts pre-approved and authorized by the broker or dealer.

- Assure that appropriate surveillance personnel receive immediate post-trade execution reports that result from market access.

Proposed Rule 15c3-5 would further require that the above-referenced controls be under the direct and exclusive control of the broker or dealer with market access, and would require such broker or dealer to establish, document, and maintain a system for regularly reviewing the effectiveness of the controls. In particular, Proposed Rule 15c3-5 would require the broker or dealer to review at least annually the business activity in connection with the market access to assure the overall effectiveness of the controls.

To support the basis for this rule-making, the Proposal frequently mentions the Commission's concern about "sponsored access arrangements, where the customer order flow does not pass through the broker-dealer's systems prior to entry on an exchange or ATS."[1] In particular, the Commission noted its concern "that, in some cases, the broker-dealer providing sponsored access may not utilize any pre-trade risk management controls (i.e. 'unfiltered' or 'naked' access), and thus could be unaware of the trading activity occurring under its market identifier and have no mechanism to control it."[2]

Prior to the Commission issuing the Proposal, and in recognition of the risks presented by sponsored access arrangements, the exchanges themselves had taken action to enhance risk controls around sponsored access. For example, both BATS and the NYSE offer its members sponsored access tools through which members can require their sponsored access order flow to pass through a filter controlled by the member before it reaches the marketplace. In the case of BATS, this sponsored access tool allows members to place restrictions on a sponsored access participant's orders, such as disallowing short sales and ISOs, limiting the maximum share size or notional value of an order, restricting the symbols allowed for trading, restricting short selling

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1 See e.g. the Proposal at p. 8.

2 Id.

to symbols identified by the member on an uploaded easy-to-borrow list, and allowing the member to completely block a sponsored access participant from further trading.[3] In addition, NASDAQ OMX recently received Commission approval of a rule imposing enhanced supervisory requirements around sponsored access arrangements, many of which are similar to those contained in the Commission's Proposal.[4] BATS anticipates submitting a rule proposal in the near future to similarly adopt a rule imposing enhanced supervisory controls around sponsored access arrangements.

While BATS supports the Commission's efforts to further enhance controls around sponsored access arrangements, the Commission's Proposal goes much further than that and instead would require such controls even when the market access is provided to another broker-dealer. The Proposal would impose this additional requirement even though the broker-dealer obtaining the market access is already required under applicable Self-Regulatory Organization rules to maintain written supervisory procedures related to its and its customers' generation of orders into the marketplace.[5]

BATS does not support this aspect of the Proposal and respectfully contends that the net result will be an unnecessary chain of redundant controls applied throughout the life of an order, which will have the effect of introducing trading friction not commensurate with any marginal and incremental risk control enhancement. BATS believes the appropriate point of focus for such controls should be at the broker-dealer responsible for the origination of an order, whether through sponsored access or otherwise. The addition of multiple layers of risk management throughout the life of an order would only marginally enhance overall risk control because a broker-dealer removed in the chain from the source of order origination cannot effectively conduct much of the required pre-trade review required by the proposed rule.

A simple example illustrates the unnecessary friction introduced by the Commission's Proposal. Consider the chain of a sponsored access customer accessing BATS through a broker-dealer. Clearly the Proposal would require that broker-dealer to satisfy the above-referenced risk management controls, and whether one agrees or disagrees with the specific controls required by the Proposal, applying them at the point of order origination seems appropriate. Nonetheless, if BATS does not execute that order in full, and depending on the instructions on the order, BATS may route that order to another market center. BATS will route the order through its affiliated exchange facility broker-dealer, BATS Trading, Inc. ("BATS BD") which itself has market

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3 See http://www.batstrading.com/resources/membership/BATS_Ex_Sponsored_Access_Specification.pdf

4 Exchange Act Release No. 61345; File No. SR-NASDAQ-2008-104 (January 13, 2010).

5 See e.g. BATS Rule 5.1 and NASD Rule 3010, both of which require members to establish, maintain and enforce written supervisory procedures to assure compliance with applicable securities laws, rules, regulations and statements of policy promulgated thereunder; see also NASD Notice to Members 04-66 (September 2004), which requires, among other things, that members have in place a supervisory system and written supervisory procedures reasonably designed to ensure that orders are not entered in error or in a manner inconsistent with NASD rules.

access. For anonymity purposes, the order may be routed under the BATS BD MPID. Per the Proposal, the Commission would require BATS BD to maintain the above-referenced risk management controls and supervisory procedures including, for example, controls reasonably designed to prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order basis. As examples of these regulatory requirements, the Commission cites "exchange trading rules relating to special order types, trading halts, odd-lot orders, SEC rules under Regulation SHO and Regulation NMS, as well as applicable margin requirements."[6]

In the absence of introducing tremendous friction into the order handling and routing process, BATS does not understand how BATS BD in the example above could be expected to ensure on an order by order basis that at the point of order origination Regulation SHO's locate requirements were satisfied, that a short sale was appropriately designated "short exempt" under the Commission's recently-approved amendments to Regulation SHO,[7] or that applicable margin requirements were met. Friction would be introduced by the need to somehow verify on an order by order basis that these requirements were satisfied. Similar friction would be introduced by other aspects of the Proposal, such as the requirement to maintain risk management controls reasonably designed to prevent any person from trading a stock that they are restricted from trading, and to prevent the entry of erroneous orders – again, BATS submits that the broker-dealer responsible for the order at the point of order origination is best placed to maintain and enforce these risk management controls.

Furthermore, as an order moves through the market it could hypothetically be touched by additional broker-dealers that presumably would be required to similarly comply with the Proposal's requirements, again adding further layers of risk management redundancy for little discernable additional risk control benefit. While it is difficult to ascertain how any broker dealer in this chain removed from the point of order origination could comply with all aspects of the Proposal, the consequences of attempting to do so are obvious – increased trading costs, including explicit costs associated with passing a single order through multiple redundant risk management mechanisms, as well as implicit costs associated with increased order handling latency, missed executions, and decreases in liquidity.[8]

For the reasons stated above, BATS respectfully requests that the Commission reconsider and reject that aspect of the Proposal that would impose its requirements on a broker-dealer with market access when that broker-dealer is providing market access to another broker-dealer. BATS believes the Proposal as drafted in this regard will create a significant, detrimental and

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6 The Proposal at p. 22.

7 Exchange Act Release No. 61595 (Feb. 26, 2010).

8 BATS notes that the Commission offered several examples in the Proposal of recent trading incidents that the Commission argues support the need for the proposed rule-making. In each case, BATS believes that if the responsible broker-dealer at the point of order origination had had appropriate controls in place the incident would have been prevented. <u>See</u> The Proposal at pp. 9-11.

unjustified market structure impact. As previously stated, BATS supports the Commission's efforts generally to enhance the risk management controls around market access; however, BATS believes such controls are best implemented at the responsible broker-dealer at the point of order origination.

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BATS appreciates the opportunity to comment on the Commission's Proposal. 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
James Brigagliano, Deputy Director, Division of Trading and Markets