



VIA EMAIL

December 29, 2008

Ms. Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

**RE: Amendments to Regulation SHO (Interim Final Temporary Rule)
Release No. 34-58773, File No. S7-30-08**

Ms. Harmon,

BATS Exchange, Inc. (“BATS”) appreciates the opportunity to comment on the above-referenced interim final temporary rule, Rule 204T of Regulation SHO (the “Rule” or “Rule 204T”) under the Securities Exchange Act of 1934 (the “Act”).¹ BATS supports the Commission’s many efforts over the past several months in acting swiftly to attempt to stabilize the U.S. trading markets, including the measures the Commission has taken to address abusive “naked” short selling in equity securities. However, for the reasons cited below, BATS believes that the Commission should carefully review and reconsider certain technical aspects of the Rule that may be having an unintended negative impact on legitimate trading activity.

In implementing Rule 204T, the Commission stated that one of its primary concerns was the “substantial threat of sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets that could threaten fair and orderly markets.”² BATS shares the concerns raised by other market participants that certain aspects of Rule 204T may actually be contributing to more volatile markets and significant price movements in certain securities, particularly at the open³ and the close⁴ of each trading day. Accordingly, BATS urges the Commission to carefully consider the impact of the Rule on the markets.

BATS has been operating as a registered national securities exchange since October 24, 2008, and previously operated an alternative trading system and electronic communications network. As an exchange, BATS is not directly subject to the requirements of Rule 204T, but nonetheless, wishes to share its views with the Commission to encourage thorough dialogue with market

¹ See Securities Exchange Act Release 58773 (October 14, 2008), 73 FR 61706 (October 17, 2008) (the “Order”).

² *Id.* at p. 3.

³ See *e.g.*, Letter from the Securities Industry and Financial Markets Association (“SIFMA”) dated December 16, 2008, commenting on the Order.

⁴ See *e.g.*, Letter from EWT, LLC dated November 25, 2008, commenting on the Order.

participants as it determines whether to extend or make permanent Rule 204T in its current or a modified form.

The Rule as implemented requires broker-dealers to close out fail-to-deliver positions by no later than the beginning of regular trading hours on the day following the settlement day (S+1), in the case of a short sale, and no later than the beginning of regular trading hours on settlement day plus three days in the case of a long sale (S+3). Absent some additional flexibility or exemptive relief, BATS is concerned that the strict temporal parameters contained Rule 204T may be contributing to market volatility and may be having other negative impacts on market efficiency.

Fails to deliver can occur in various ways resulting from legitimate trading and securities lending activity. For example, broker-dealers frequently finance long positions by lending the securities, and that supply of lendable securities furthers market efficiency. If a long position needs to be recalled, that recall is typically structured to occur on the settlement date, (S), for the sale that created that recall requirement. If, for whatever reason, the securities are not returned on (S), under Rule 204T the broker-dealer lender is required to close the fail resulting from the long sale by buying in the securities no later than the market open on (S+3). In practice, however, that buy-in cannot be completed until the close of settlement on (S+3).

The net result of this scenario is that securities lending has become a more risky and, hence, costly proposition. We are concerned that some market participants are unwilling to make tight and deep markets, particularly near the close of trading because they are less able to manage the risks associated with having to recall loaned securities. Alternatively, we are concerned that market participants may refrain from financing long position through securities lending, which has the effect of increasing trading costs and diminishing the efficiency of the markets.

BATS supports suggestions by other commenters, including SIFMA and NYSE Euronext, to improve the Rule without drastically reducing its intended effect of reducing or eliminating abusive “naked” short selling in equity securities. Among those suggestions are increasing the amount of time for close out before placing a broker-dealer in the “Penalty Box” (*e.g.*, end of the applicable trading day rather than at the open), allowing certain actions to count as closing out of positions (*e.g.*, borrowing for long fails and bona-fide recalls by market makers), and a de minimis exception. BATS does not, however, support initiatives suggested by some that would lead to potentially disparate treatment for certain market participants on certain market centers. Rather, BATS believes that the standards imposed by the Commission regarding short sales, fails-to-deliver, and related matters should be clear and enforceable for all similarly situated market participants across all markets where such market participants may trade. Based on the foregoing, BATS respectfully requests that the Commission carefully examine any unintended consequences of Rule 204T in the context of ensuring the maintenance of market efficiencies consistent with the policies underlying this rule-making.

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BATS appreciates the opportunity to comment on Rule 204T. Please contact the undersigned at 212-378-8523 with any questions you may have in connection with this matter.

Sincerely,



Eric Swanson
SVP & General Counsel
BATS Exchange, Inc.

cc: Christopher Cox, Chairman
Luis A. Aguilar, Commissioner
Kathleen L. Casey, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
Erik R. Sirri, Director, Division of Trading and Markets
Robert L.D. Colby, Deputy Director, Division of Trading and Markets
James A. Brigagliano, Associate Director, Division of Trading and Markets