



August 16, 2010

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

**RE: SR-BATS-2010-016**

Ms. Murphy:

BATS Exchange, Inc. (“BATS”) is responding to several comment letters submitted in response to the above referenced rule filing related to modifications to BATS’ rule governing clearly erroneous executions. In particular, BATS is responding to concerns raised by one commenter related to the manner in which news or information regarding the review and cancellation of clearly erroneous trades will be disseminated to the market, and several commenters’ concerns generally about the clearly erroneous thresholds and determination of an appropriate reference price.

At the outset, BATS notes that its proposal was the product of numerous discussions between the exchanges, FINRA, and staff from the Securities and Exchange Commission (“SEC” or “Commission”). Certain guiding principles formed the basis for BATS’ proposal, particularly, the need in the aftermath of May 6<sup>th</sup> to provide enhanced objectivity and certainty associated with the circumstances under which a particular execution would be deemed clearly erroneous, the corresponding need to limit to the greatest extent possible discretion afforded BATS in its existing clearly erroneous rule, and the desire to avoid encouraging moral hazard associated with orders submitted into the national market system.

BATS recognizes that its proposal does not in all circumstances provide 100% advanced certainty with respect to whether a particular execution will be deemed to be clearly erroneous; however, BATS believes its proposal reflects a significant improvement in this regard over its existing rule. In addition, BATS recognizes there can be reasonable disagreement over the exact parameters chosen to satisfy the principles that guided BATS’ effort to revise its clearly erroneous rule; however, BATS believes that those parameters contained in its proposal are reasonable, and necessary and appropriate, consistent with the Exchange Act of 1934 (“the Act”).

**Dissemination of Information Regarding Clearly Erroneous Determinations**

One commenter noted that BATS’ proposal does not state how news or information regarding the review and cancellation of clearly erroneous trades will be disseminated to the

market.<sup>1</sup> BATS' proposal is intentionally built on existing rules and practices and is tailored to achieve increased certainty with respect to clearly erroneous executions. BATS already has its own methods for communicating with its respective members and BATS believes the industry is already aware of and accustomed to these methods. BATS does not believe that a specific method of communication should be required by the proposal, but instead believes that communication methods with members should remain flexible, especially in light of the fact that communications methods are constantly changing.

BATS currently generates email messages to its members with respect to clearly erroneous execution reviews and determinations. Specifically, when a widespread problem affecting one or more securities impacts several members, BATS sends a notification to all representatives of BATS participants that have subscribed to a specified BATS distribution list. Such notification indicates that executions in a specified security or securities that occurred during a specific time period are under review. Alternatively, if only a few parties to a transaction are affected by a clearly erroneous execution review, the correspondence is generated and sent only to the affected parties. BATS believes that it has effectively achieved a balance between notifying its membership of significant events of which market participants should be aware and avoiding notifications every time that a transaction is reviewed as potentially clearly erroneous. Accordingly, BATS believes that existing requirements that an SRO promptly notify affected members of clearly erroneous reviews and determinations are sufficient. BATS notes that it is in regular contact with its membership regarding additional tools that would be worthwhile to such members, but it is not aware of demand from its members for additional notifications or a different method of notification of clearly erroneous reviews and determinations.

In addition to consistency and speed of notification, the commenter noted that the BATS' clearly erroneous rule should require BATS to disseminate information in a non-discriminatory manner and "not favor any one group of market participants over another."<sup>2</sup> Based on existing notification practices, BATS is not aware of any risk of discrimination amongst participants with respect to clearly erroneous execution reviews. As set forth above, BATS follows consistent methods in notifying participants of clearly erroneous reviews and determinations, with the only decision left to BATS personnel being whether the event in question is of a magnitude that all BATS members would like to know that BATS is conducting a review or has ruled, or if a targeted communication to only the affected parties would instead be appropriate. Finally, BATS believes that the anti-discriminatory requirements of the Act would sufficiently restrain BATS from favoring one group of market participants over another with respect to notifications.

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<sup>1</sup> See letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC, dated July 19, 2010.

<sup>2</sup> Id.

### Thresholds

For securities subject to a single stock circuit breaker, one commenter questioned BATS' decision to propose application of clearly erroneous thresholds of 10%, 5%, or 3% (depending on the price of the security) away from the single stock circuit breaker trigger price.<sup>3</sup> The commenter suggested that because the single stock circuit breaker trigger price already reflects a move of 10% in the security over a rolling 5 minute period, application of an additional 10%, 5%, or 3% threshold from that trigger price to determine which executions are clearly erroneous reflects an unjustified contraction of the circumstances under which BATS will deem a particular execution to be clearly erroneous.<sup>4</sup>

BATS believes that its proposal reflects a rational and reasonable application of objective criteria to address clearly erroneous transactions. Because of the nature of the circumstances under which a circuit breaker might be triggered, BATS does not believe it is accurate to suggest that in all circumstances use of the circuit breaker trigger price as a reference price from which to measure the clearly erroneous percentage thresholds reflects a contraction of the circumstances under which a particular execution is deemed to be clearly erroneous. For example, a security might gradually move over a rolling 5 minute period towards a circuit breaker trigger price, in which case, the circuit breaker threshold reflects a rational and objective reference price from which to apply the applicable clearly erroneous thresholds.

Alternatively, a security might move quickly through multiple price points that hit the circuit breaker trigger price. In such circumstances, it is certainly possible that an execution that might be deemed clearly erroneous today might not be deemed clearly erroneous under BATS' proposal; however, unlike today, the determination of the reference price in this instance is objective and defined such that market participants have a greater degree of certainty as to whether their trade will stand or be broken. In any event, however, as stated at the outset, BATS' proposal reflects enhancements to its existing clearly erroneous rule that satisfies the guiding principles of promoting objectivity and certainty, retaining limited discretion only where necessary, and discouraging moral hazard. While other methods could likely be found to achieve these objectives, BATS believes its proposal reflects a rational approach that is consistent with the Act.

Some commenters also raised the general question of the different reference prices that could be used to measure whether a particular execution is clearly erroneous, arguing either that BATS' proposal is confusing in this regard or continues to provide too much discretion to BATS, and presumably a lack of clarity as to whether a particular execution will be deemed to be clearly erroneous.<sup>5</sup> BATS notes in response to these concerns that its proposal is designed to be

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<sup>3</sup> See letter from Ann Vlcek, Managing Director and Associated General Counsel, Securities Industry and Financial Markets Association, dated July 26, 2010.

<sup>4</sup> Id.

<sup>5</sup> See letter from Ira Shapiro, Managing Director, BlackRock, Inc., dated July 20, 2010; letter from Karrie McMillan, General Counsel, Investment Company Institute, dated July

abundantly clear and objective that if a security is subject to a single stock circuit breaker, the reference price will be the circuit breaker trigger price. For those securities not subject to a circuit breaker, the rule is designed to generally guide BATS to look to the last sale as the reference price. That said, however, because there are circumstances under which last sale would be an inappropriate reference price, it is critical for BATS to retain some limited discretion in the rule to use a reference price other than last sale for the purposes of applying the clearly erroneous thresholds.

Similarly, with respect to multi-stock events involving 20 or more securities, BATS believes it may be more appropriate to look at executions occurring in multiple securities at a single point in time and to apply the thresholds from the transaction prices at that point in time. In fact, this was exactly the methodology employed by the exchanges and FINRA on May 6<sup>th</sup> in determining which trades would be broken as clearly erroneous and which trades would be allowed to stand. And, while the process the exchanges and FINRA employed on May 6<sup>th</sup> to reach this determination was lengthy and subject to legitimate criticism, the reasons for that delay had nothing to do with the decision as to the point in time from which to derive the appropriate reference price. That decision was abundantly clear and was reached very quickly. What took time was the effort to determine the appropriate break threshold from the reference prices at that point in time, and, as the SEC knows, the exchanges and FINRA ultimately broke those trades that were at least 60% away from the determined reference prices.

While BATS acknowledges that there will remain some uncertainty associated with the selection of the reference prices in broad market events that involve securities not subject to a circuit breaker, BATS believes that this uncertainty will be significantly mitigated because its proposal defines the threshold (30%) applicable to such events. BATS believes that it will be able to quickly determine the reference price by selecting the point in time from which to measure those prices, and then, as proposed, the rule would not provide BATS the flexibility to consider the pros and cons of various possible clearly erroneous thresholds – all trades at or greater than 30% away from the references prices will be broken. Accordingly, while there does remain some limited discretion in the rule associated with selection of a reference price for securities not subject to a single stock circuit breaker, BATS' proposal generally guides BATS to consider last sale unless the last sale would not be an appropriate reference price or if there is a multi-stock event involving 20 or more securities not subject to a single stock circuit breaker. For the reasons stated above, BATS believes discretion in these limited circumstances to determine a reference price other than last sale is necessary and appropriate and consistent with the Act, reflects an improvement in certainty over the existing rule, and is further mitigated by the on-going expansion of single stock circuit breakers to additional securities.<sup>6</sup>

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19, 2010; letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC, dated July 20, 2010; letter from Peter Ianello, Partner, CSS, LLC, dated July 15, 2010.

<sup>6</sup> See, e.g. SR-BATS-2010-018 (proposing the expansion of the single stock circuit breakers to securities included in the Russell 1000® Index and specified Exchange Traded Products).

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In a similar vein, one commenter expressed concern over the retention of language in the rule that would allow BATS to utilize “additional factors” in certain limited circumstances to determine whether an execution is clearly erroneous.<sup>7</sup> Such additional factors include, for example, systems malfunctions or disruptions, volume and volatility for the security, the derivative nature of a security, and news released on the security. This commenter expressed concern that the retention of this language in the rule detracts from the goal of providing certainty with respect to whether a particular execution will be deemed to be clearly erroneous.<sup>8</sup> While BATS agrees that the retention of this language does continue to provide BATS discretion, BATS stresses that this discretion is limited under its proposal to instances involving less than five securities under review, and further limited to securities that are not subject to a single stock circuit breaker. BATS believes that in these limited circumstances, it is necessary and appropriate to retain some level of discretion because it may be necessary to consider additional factors in the interest of maintaining a fair and orderly market.

Again, BATS recognizes that its proposal does not provide 100% clarity and objectivity in all circumstances with respect to the determination of whether a particular execution will be deemed clearly erroneous; however, BATS believes its proposal represents a vast improvement in this regard over the existing rule. In addition, BATS notes that the proposed changes to its rule regarding clearly erroneous executions are proposed to be implemented as a pilot program corresponding to the single stock circuit breaker pilot program currently in effect. BATS anticipates that as it gains experience under the revised rule, additional areas of improvement may become evident and further modifications proposed.

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BATS appreciates the opportunity to provide this response to comment letters submitted on the above-referenced filing. Please feel free to contact me if you have any questions in connection with matter.

Sincerely,



Eric J. Swanson  
SVP & General Counsel

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<sup>7</sup> See letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC, dated July 20, 2010 at 4.

<sup>8</sup> Id.