

February 2, 2015

Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington DC

Re: Release No. 34-76470, File No. SR-BATS-2015-101, Notice of Filing of a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Adopt Rule 8.17 to Provide a Process for an Expedited Suspension Proceeding and Rule 12.15 to Prohibit Disruptive Quoting and Trading Activity

Dear Mr. Fields:

Thank you for the chance to comment again on the above-noted BATS filing. The SEC should not approve any filing justified even in part by puffery and misdirection. Adopting BATS executives' own pleadings about regulatory actions, the SEC should only approve data-driven, principles-based regulatory initiatives.<sup>1</sup>

My comments are in response to a BATS January 21, 2016 letter, in which BATS writes:

Citing only unspecified "press accounts," Leuchtkafer states: "[s]o far as I can tell BATS has never independently discovered spoofing conduct, not once, ever, on any of its four markets ...." Leuchtkafer is incorrect. BATS has implemented a robust surveillance and investigation program to detect, investigate, and enforce layering and spoofing violations, as well as other violative conduct. For publicly available proof, Leuchtkafer need look no further than the Letters of Acceptance, Waiver, and Consent from the Hold Brothers Online Investment Services LLC and Biremis Corp. BATS enforcement actions to see that the Exchange conducts surveillance and detects, investigates, and enforces spoofing and layering activity.<sup>2</sup>

Whether BATS has implemented "a robust surveillance and investigation program" wasn't the issue. The issue was whether BATS *independently* discovered any one of the egregious layering or spoofing cases BATS used to justify its deeply flawed proposal, and the issue goes to the credibility of its prescriptive checklists. While the Hold Brothers enforcement action includes a wonderful principles-based definition of spoofing and layering<sup>3</sup> BATS could include in its rulebook (but for some reason refuses to do), perhaps BATS can point to where in that action it's clear that BATS *independently* discovered the violative conduct. This is important because BATS refers to its "robust" surveillance and investigation program, and BATS says it has observed "certain cases of the manipulative practices of 'layering' and 'spoofing' that are so obvious and uncomplicated that they leave little to question regarding the impropriety of the behavior." These cases are "simple" and "brazen" and BATS is "helpless" to stop them, but for some reason BATS doesn't provide a single current example from any of its four markets, not even to count them and say

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<sup>1</sup> Statement of Chris Concannon to a hearing of the House Committee on Agriculture, February 3, 2009, "[W]e believe the key concept to keep in mind is to apply modern regulatory concepts like the principles-based approach to regulation practiced successfully by ... regulators around the world"; in testimony to a hearing of the Senate Permanent Subcommittee on Investigations, June 17, 2014, Joe Ratterman told legislators that "market quality and stability can be improved" and authorities should "consider responsible, data-driven regulatory action where appropriate."

<sup>2</sup> Letter to Brent J. Fields, Secretary, Securities and Exchange Commission, from Anders Franzon, SVP Associate General Counsel, BATS, January 21, 2016.

<sup>3</sup> Such as, "the use of non-bona fide orders, or orders that the trader does not intend to have executed, to induce others to buy or sell the security at a price not representative of actual supply and demand."

something like "BATS has found three current instances of simple and brazen spoofing and layering that we are helpless to stop." Instead, BATS is silent. Why?

As for those "unspecified 'press accounts'" BATS pooh-poohs, perhaps newspapers are slow to make it to Lenexa, so here are some of them:

In "Day-Trading Firm Fined Over Manipulative Dealings" by Scott Patterson and Jenny Strasburg, reporting about the Hold Brothers case, the Wall Street Journal said that "A computer-trading firm complained to the SEC in the summer of 2010 about what it suspected was manipulative behavior, leading investigators to dive into Hold's records, according to people close to the investigation."

In "Trader Arrested in Manipulation that Contributed to 2010 'Flash Crash'" by Nathaniel Popper and Jenny Anderson, reporting about the Sarao case, the New York Times said that "authorities were led to [Sarao] only with the help of an outside whistle-blower."

BATS points to the Hold Brothers, Sarao, and Biremis cases as examples of a spoofing crisis it is helpless to put a stop to quickly, and in these press accounts we're told that regulators didn't first identify at least two of those three examples<sup>4</sup> - not even BATS, not even with its robust surveillance and investigation capabilities or its checklists. As for Biremis, the violative conduct apparently began in 2007, quite some time before BATS became an exchange.

BATS then goes on to misread my criticisms of its proposals, putting up a strawman to knock down:

Leuchtkafer advocates that the Exchange *must* adopt "principles-based" language *instead* of the Exchange's current proposal.

Well, no. My concluding remarks are:

Before BATS takes on spoofing, BATS must amend its Filing to include a principle. That's how to make markets better. Some excellent language would be something like this:

No Member shall enter or cause to be entered, an order with the intent, at the time of order entry, to cancel the order before execution, or to modify the order to avoid execution.

And then in its rule interpretations BATS must be clear that whatever its checklists say, they aren't comprehensive, and any behavior violating the principle will be sanctioned.

For any rulebook definition of what an equities exchange believes spoofing and layering<sup>5</sup> to be, a definition likely soon to be copied by several or even all of the other equities exchanges,<sup>6</sup> the SEC should require the exchange to *also* include in its rulebook a clearly articulated principle rather than *only* a prescriptive checklist, particularly when so far as I can tell that exchange hasn't yet independently detected the proscribed behavior on its markets and hasn't documented any current enforcement proceedings its proposal could expedite in the future. A further point is that by detailing exactly what BATS believes the violative conduct to be, order-by-order, at a level of detail it has nowhere else, BATS gives miscreants a

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<sup>4</sup> As should be clear in my comment letter, I'm well aware Sarao's violative conduct was on a futures exchange. BATS introduced the case as support for its rule filing, however, and comment on it, how it was detected, and my observation that BATS's proposal failed to prohibit at least some of Sarao's conduct are entirely relevant.

<sup>5</sup> "Spoofing and layering" now appears as "Disruptive Quoting and Trading" in the rule, which the Statement of Purpose makes very clear should really be read as spoofing and layering.

<sup>6</sup> "Wall Street ready to fight against high-speed trading 'spoofers'", New York Post, August 22, 2015.

roadmap around its robust surveillance and investigation capabilities and gives the regulatory defense bar a template for excusing anyone who cooks up a way past the checklist.

My greater point is that many public and industry complaints over spoofing are about quoting and trading tactics some firms engage in as a matter of course.<sup>7</sup> One prominent firm, and likely a good BATS customer, argues in part that because IEX might hobble a firm from quoting more stock in the National Market System in the same name, at the same price, on the same side, at the same time than it apparently intends to trade, the IEX exchange as proposed should be turned down.<sup>8</sup> A prominent high-speed trading firm executive has said publicly that firms quote more than they intend to trade.<sup>9</sup> By every definition of spoofing I've noted in my previous comments on this proposal, this is a spoofing tinderbox in equities markets today, and the SEC shouldn't let an exchange strike a pose against spoofing without addressing it.

Sincerely,

R. T. Leuchtkafer

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<sup>7</sup> A well-known example is *Flash Boys*, Lewis (2014).

<sup>8</sup> Letter to Brent J. Fields, Secretary, SEC, from Adam Nunes, Head of Business Development, Hudson River Trading, December 4, 2015.

<sup>9</sup> Letter to Brent J. Fields, Secretary, SEC, from R. T. Leuchtkafer, December 14, 2015.