GETCO

GLOBAL ELECTRONIC TRADING COMPANY

June 4, 2009

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

Re: Comments Regarding SR-NASDAQ-2009-043 ("Flash Order"); BATS SR-BATS-2009-14 ("Bolt Order"); Direct Edge ECN's ELP Program

Dear Ms. Murphy:

Global Electronic Trading Company ("GETCO")[1] appreciates the opportunity to comment on SR-Nasdaq-2009-43 and SR -BATS-2009-14, which are similar to Direct Edge ECN's Enhanced Liquidity Provider Program ("ELP") (the "Rule Changes" or "Proposals"). These Rule changes would permit an Exchange member to lock the National Best Bid or Offer ("NBBO") by displaying a marketable order on internal exchange data feeds to other Exchange members for a half-second (500 milliseconds) or less before the order is routed to an away market or cancelled; thereby allowing Exchange members to "step-up" and execute the order.[2] Both Proposals were filed as "non-controversial." BATS and Nasdaq determined that their filings are similar to CBSX's Rule 52.6 which allows for "step-up" orders. Additionally, GETCO notes that Direct Edge ECN's ELP program is currently available to Direct Edge Subscribers and, presumably will continue to apply if the Commission approves Direct Edge's recently filed Exchange Application.

GETCO believes that the emergence and proliferation of pre-routing display functionality ("step-up"; "flash"; "bolt" orders) to select groups of market participants raises numerous and important market structure issues for the public equity markets regarding best execution, transparency, competition and the overall value that should be placed on the public display of limit orders. These order types also raise questions regarding compliance with Regulation NMS and Regulation ATS.

1 GETCO, with offices in Chicago, New York, London and Singapore is a privately-held, electronic trading firm that provides liquidity to exchanges and Alternative Trading Systems ("ATSs") in the US, Europe and Asia. GETCO, an early entrant in electronic trading, utilizes automated trading models to trade on various exchanges and ATSs. GETCO is a registered market maker on various equity exchanges including Nasdaq, BATS and NYSE Arca.

2 If a locking order that is displayed on internal exchange data feeds is executed, the exchange member will not pay a liquidity removing fee, and may in fact receive a rebate from the exchange. The customer would typically be required to pay a fee if the marketable order were routed to an away market.

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Commission Staff has recently highlighted as a regulatory concern "the transmittal of pre-trade messages about available liquidity" that "could create the potential for significant private markets to develop that exclude public investors."[3] In addition, Commission Staff has recently focused on whether pre-trade order information could negatively effect "competition among trading centers and market fragmentation."[4] The market structure implications raised by these Proposals are significant enough that the SEC should, at a minimum, solicit more in-depth comments from the industry on what role dark liquidity and "step-up" orders should play in our National Market System.

With the above in mind, GETCO would like to offer its views on the Proposals. Our comments will address the potential market structure and price discovery consequences if "step-up" orders become an accepted and widespread industry practice. GETCO believes that the Proposals could lead to: (1) a two-tiered market structure in which only select market participants receive order information; (2) reduced incentives to publicly display limit orders; (3) impaired price discovery in the public markets; and (4) inferior executions for customer orders that utilize the new order types. These concerns are discussed in detail below.

A. Two-Tiered Markets

The Commission has previously determined that the development of two-tiered securities markets harms investors, particularly retail investors. With the adoption of Regulation ATS in 1998, the Commission took action to eliminate the two-tiered market that had developed where certain broker-dealers and other institutional investors who subscribed to ECNs routinely had access to better priced orders than were available to the broader market, including retail investors. In adopting Regulation ATS, the Commission stated that the incorporation of all customer orders into the public quote stream (i.e., the "SIP") would, among other things, improve the NBBO and eliminate the unfairness associated with a two-tiered market system.[5] In addition, the Commission required the immediate and public display of limit orders so that all market participants could access them.[6]

Allowing market centers to display marketable limit orders--through that market center's own private data feed--that are priced better than the current quote on that market only to select market participants rather than being immediately routed or displayed to the entire market through the public SIP feed seems contrary to the policy objectives of Regulation ATS. Allowing only Exchange members to access marketable limit orders that would

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3 See Speech by James A. Brigagliano, Co-Acting Director, Division of Trading and Markets, U.S. Securities and Exchange Commission, May 20, 2009.

4 Id.

5 See, e.g., Securities Exchange Act Release No. 34-41297 (December 8, 1998), 63 FR 70844 (December 22, 1998).

6 See, e.g., Securities Exchange Act Release No. 37619A (Sept. 6, 1996), 61 FR 48290 (September 12, 1996).

improve that market center's quote, even if this advance look is for less than a second, could once again engender the development of two-tiered markets in NMS securities. This is particularly true in today's market environment where electronic, high-speed trading exchange technology permits market participants to place and execute thousands[7] of orders in multiple symbols in less than a second. For example, on 5/29/2009 symbol JPM alone traded 203[8] times in a 500 millisecond period, during which time the midpoint price of JPM changed 48[9] times on Nasdaq. If only Exchange members are given the opportunity to execute against an order that locks the NBBO then the broader market would be deprived of critical market information in a manner that affects not only other market participants that would be willing to execute against the better priced order but also would result in worse prices to those orders whose prices are determined by reference to the NBBO.

Rule 602 of Regulation NMS (the "Quote Rule") requires each exchange to make available to the public its best bid and offer for each security for which it trades. Rule 602 generally would preclude an Exchange from failing to incorporate immediately into the public quote stream the better priced limit orders that would be displayed only to other Exchange members under the Rule Changes. However, the Quote Rule contains an exception that excludes from the Quote Rule's general provision any order that is executed immediately.[10] It has been argued that "step-up" orders fall within this exception because they will only be displayed temporarily (500 milliseconds or less) to Exchange members and that such temporary delay prior to routing to the better away market or cancellation would fall within the Quote Rule's "immediate execution" exception.

In today's trading environment, where electronic exchanges can execute thousands of orders in less than a second, a delay, of up to a half-second or less, should not be considered an "immediate" execution. By way of example, immediate or cancel ("IOC") orders are typically executed in half a millisecond. Given that it could take a "step-up" order 1,000 times longer to be executed than an IOC, it is GETCO's opinion that this is a meaningful amount of time and therefore "step-up" orders are not "immediately executed."

The Quote Rule is designed to ensure that all market participants have equal access to an exchange's best bids and offers, since the NBBO is determined based upon the best bids

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7 The BATS exchange reports peak message rates of 166,000 per second, including orders, cancels, and modifies. http://www.batstrading.com/resources/features/bats_exchange_Latency.pdf.

8 Trade data measured from NYSE TAQ files on 5/29/2009 from 9:40:46.000 to 9:40:46.999. This was the maximum number of midpoint price changes in JPM for that day during a 500 millisecond period.

9 Quote data measured from Nasdaq's proprietary quote feed ITCH.

10 Rule 602(a)(1)(i)(A) states that any "bid or offer executed immediately after communication and any bid or offer communicated by a responsible broker or dealer other than an exchange market maker which is cancelled or withdrawn if not executed immediately after communication" is exempt from the display requirement of the Quote Rule.

and offers for an NMS stock across all exchanges on which it is traded. Allowing only Exchange members to access better priced marketable orders, even if only for a very short period of time, is, in our opinion, inconsistent with the policy objectives of the Quote Rule and could negatively affect the broader market, including retail investors who rely on the NBBO to ensure that their orders obtain the best, reasonably available price.

GETCO believes that the market structure principles of competition and equal and fair access to critical price information espoused by the Commission in Regulation NMS and Regulation ATS dictate that the Commission carefully weigh the positive elements in the use of "step-up" orders with the potential that two-tiered equities markets once again, may begin to develop and harm certain investors.

B. <u>Reduces Incentive to Display Liquidity</u>

Another market structure concern raised by the Rule Changes is that the incentive to display aggressively priced liquidity is reduced, possibly harming the public price discovery function provided by the quoting public markets. The Proposals allow market participants to leverage a competing exchange's displayed liquidity without necessarily routing orders to the better prices on competing exchanges.

If "step-up" order functionality proliferates amongst all the equities exchanges, it would serve as a disincentive for market participants to display liquidity at better prices because they will increasingly not be rewarded with an execution, even as they provide valuable information to the market as whole through the public posting of orders. Such a market structure discourages competition among liquidity providers and eventually leads to wider public spreads. Internalization becomes even more profitable as spreads widen, which will cause the practice to grow, ultimately harming investors who are not part of the step-up network, particularly retail investors.

Market participants interested in finding the best priced orders to execute against would be encouraged to join the disparate system of "step-up" order display systems on the various exchanges so that they could execute against better priced "step-up" orders without displaying limit orders on public markets. Discouraging market participants from displaying liquidity at better prices harms the entire market, and in particular, it harms retail investors whose orders are often internalized and priced at the NBBO.

The market structure components of a "step-up" process are borrowed from a traditional floor-based practice that is no longer applicable in today's electronic markets. In the floor based trading environment, a customer order was represented to the crowd for either price improvement or to save the broker-dealer representing the order the latency and opportunity cost of routing the order to an away market center. In that instance, if an order had a three second exposure in which to allow participants of that particular market center to "step up" and execute against it, there was the potential to save a 1-minute delay because the order may not need to be routed as a result of the step-up. This type of scenario seems to be a justifiable trade-off between rewarding those that publicly display liquidity and a market center's ability to leverage an away market's public quotation to execute a customer's order at a better price and in a timelier fashion.

In today's electronic markets, however, vigorous competition has resulted in technology improvements that have dramatically reduced the amount of time it takes to access an away market. Most major exchanges can be accessed in single digit milliseconds, and will likely get faster. As such, allowing a "step-up" display period of 500 milliseconds does not provide the same benefit as the traditional floor based model and may only cause customers to "miss the market" because of the "step up" process.

C. Price Discovery and Dark Liquidity

The Commission has recently expressed interest regarding the effect dark liquidity can have on price discovery on the public markets. It is GETCO's view that there is a fundamental distinction to be made between "step-up" orders and dark liquidity. While neither dark liquidity nor "step-up" orders contribute to price discovery on the public markets, true dark liquidity is just that--dark--and if certain thresholds are met, all dark liquidity is accessed in a consistent manner.

When a market center treats all orders in a uniform manner, it prevents discrimination or unequal access among market participants. In contrast, step-up orders inherently discriminate among market participants by providing an informational advantage to Exchange members who access the Exchange's private data feeds, i.e., a two-tiered market. The Commission has explicitly noted that the risks of a two-tiered market, however, are diminished when orders are fully dark and not displayed to select market participants, as they are in the "step-up" process. In adopting Regulation ATS the Commission stated: "when orders are not displayed to anyone, the Commission's concerns about a two-tiered market—where some market participants have information others do not—are absent." [11]

GETCO believes that the proliferation of "step-up" orders could negatively effect competition among trading centers and reduce the effectiveness of the public markets ability to efficiently discover prices.

D. Best Execution

An order routing broker-dealer's duty of best execution requires that the firm seek the best price reasonably available among all market centers. An order routing broker-dealer's commercial interests could be in conflict with its customers' interests if the broker is motivated to reduce execution costs at the expense of better prices for its customers. Although an order-routing firm will often pay less in fees (or receive a rebate) by utilizing a "step-up" process, doing so can often result in inferior executions for customer orders because the NBBO can worsen (i.e., a customer may miss the

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11 Securities Exchange Act Release No. 34-41297 (December 8, 1998), 63 FR 70844, 70867 (December 22, 1998).

market) during the 500 millisecond display period---a significant period of time in today's electronic markets. Many investors, including retail investors, may not be fully aware that they may receive worse executions so that their routing broker-dealer can reduce execution costs.

Furthermore, although some investors may choose to accept the trade-off between reduced execution costs and receiving potential inferior executions because of a "step-up" process, GETCO believes that there is currently little regulatory oversight of these trading practices from a best execution perspective.[12] Moreover, GETCO is also concerned that the order information that certain market participants receive as part of the "step-up" process could be used to harm the customer that is sending the order (e.g., "step up" order recipients could front-run those orders). Simply put, to properly surveil for compliance, it is necessary to know who receives order information and what actions they took prior to that order receiving an execution. While the audit trail may show that an order was routed to a particular market center, the participants who have access to the order details in the "step-up" process are not identified, and may choose not to execute the order and instead may trade ahead of that order. It is our understanding that the existing audit trails may lack the requisite information to link this behavior appropriately through the "step-up" process.

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E. Conclusion

The emergence and proliferation of pre-routing display functionality to select market participants raises numerous and important market structure questions regarding the future of fundamental regulatory principles upheld by the SEC through Regulation NMS and ATS. Those principles include providing fair access to information; fostering vigorous competition among participants; promoting transparency of information; and supplying incentives to market participants to publicly display limit orders. The Commission's consistent endorsement of these regulatory tenets has encouraged the development of highly efficient, accessible equity markets and provided numerous benefits to the investing public, including lower barriers to entry and decreased trading costs.

As we stated at the outset of our letter, the market structure implications raised by these "step-up" proposals are significant enough that we propose that the Commission, at a minimum, solicit more in-depth comments from the industry on what role dark liquidity and "step-up" orders should play in our National Market System. Regardless of the outcome, it is a debate worth having.

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12 GETCO is also concerned that important order information is not captured thereby making it difficult for regulators to reliably identify instances in which violative conduct occurs. Best execution and front-running surveillance would require information that is currently unavailable in existing order audit trail data (i.e., "OATS" data).

GETCO appreciates the opportunity to submit these comments. Please do not hesitate to contact us at (312) 242-4600 if you have any questions regarding any of the comments provided in this letter.

Sincerely,

Stephen Schuler

Stephen Schuler
Managing Member

Daniel Tierney

Daniel Tierney
Managing Member