

Dear BATS Customers and Members of the Trading Community,

BOLT/Flash/ELP - Still in the News

Several weeks ago, on July 7th, I distributed a newsletter detailing potential issues that could arise with the order handling functionality called “BOLT”, “Flash”, or “ELP”, depending on which market you are referencing. In case you didn’t see it already, the full text of that newsletter is on our website: (<http://www.batstrading.com/resources/newsletters/2009-07-Newsletter.pdf>).

Even before my July 7th newsletter, we actively voiced concerns, publicly and repeatedly, about this functionality. I sat on the SIFMA market structure conference Exchange Panel in June and detailed these same concerns to the other panelists and the audience of market participants and industry media. Two weeks later I sat on another panel at the Sandler O’Neill conference and detailed the same points again.

To be absolutely clear – BATS would support a ban on flashed orders based on the rational concerns listed in our July 7th newsletter. If a ban would relieve pressure and give our industry the pause necessary to review and reconsider flashed order functionality, then let’s collectively go that route. Nasdaq, DirectEdge, CBSX ... are you open to a coordinated approach to withdrawing flashed orders? We are.

At the same time, we would like to point out that some of the recently hyped allegations surrounding flashed orders are unfounded, and allude to seemingly scandalous behavior. Four such allegations regarding flashed orders are discussed below:

Misstatement 1: Flashed orders create unique front-running opportunities.

Our response: BATS BOLT orders do not create unique front-running opportunities.

Longer explanation: We think it is disingenuous to suggest that orders that are widely published to an exchange’s full membership, distributed to several market data vendors, and even displayed in real time on several mainstream financial websites, could create meaningful front-running opportunities. That said, we recognize that illegal front-running can occur in a variety of contexts, and nothing about BOLT orders raises unique issues in this regard. Importantly, exchanges and member firms have the responsibility to detect, and take enforcement action against, illegal front-running, regardless of the context in which it occurs.

Misstatement 2: Flashed orders are used solely by high speed trading firms.

Our response: BATS BOLT orders are used by a wide variety of firms.

Longer explanation: The types of customers using this functionality are broad and encompass all kinds of firms, from retail brokers, to institutional participants, to proprietary trading firms, to automated market makers, to agency brokers, and so on. There is no single profile that describes firms that are using the functionality.

Misstatement 3: Flashed orders disadvantage retail investors.

Our response: BATS BOLT orders benefit traders and investors, including retail investors.

Longer explanation: Flashed orders typically provide price improvement to investors who execute against them. While orders are being flashed, they are effectively compressing the spread between the bid and ask down to zero. Normally the spread for any security is bound by a minimum 1 penny increment between the bid and ask. For example, stock XYZ might be quoted in the national market as \$23.10 bid x \$23.11 offered. A BOLT enabled order first executes against all available bids (or offers)

at BATS and then is disseminated to all BATS members as a quote one penny better than was available before the order came in. In the previous example, an order to buy at \$23.11 would execute against all available orders on BATS to sell at \$23.11, and when the book has been totally cleared, the remainder of that order is published as a (better priced) bid at \$23.11. Market participants, retail investors included, are then able to benefit from executions against these flashed orders and receive the price improvement they offer.

Misstatement 4: Exchanges intended to flash quotes solely to their own members.

Our response: BATS actually prefers to disseminate BOLT orders publicly.

Longer explanation: A primary driver behind BOLT was to publish better priced quotes as widely as possible given the current regulatory limitations. BATS would prefer that BOLT quotes be publicly disseminated through the consolidated tape. They represent better priced orders and we believe they need to be published widely to the entire industry. Doing so, however, would create temporary conditions where bids are equal to offers and offers are equal to bids (i.e. locked markets), and this is not allowed under the current regulatory environment. All BATS orders, including BOLT orders, are published through our market data feeds (which are provided free of charge). BATS quotes, including BOLT quotes, are even published in real time on the Internet through several of the most popular financial portals. The only place you can't find BOLT orders is on the consolidated tape, and we would post them there too if the regulatory structure allowed it. Simply stated, the BATS implementation made flashed quotes available to as wide an audience as currently allowed by securities law.

Provocative suggestion: If the existing regulatory structure was modified to make locked quotations acceptable, and all quotes (flashed or otherwise) were then reflected in the consolidated tape, then the potential issues associated with flashed orders might find acceptable resolution. Maybe flashed orders are really just innovative implementations designed to work around the limitations of a regulatory framework that currently seeks to avoid locked markets. It's likely to be yet another hot topic, but one that we propose be revisited in light of how the market has evolved over the last couple of years.

It needs to be said again - there are valid reasons to review, debate, and even ban flashed orders. I listed six of those reasons in our last newsletter. It's equally important to make clear, however, that there are accusations being circulated recently that are distorting the perception of how these systems actually work. The difference between the real concerns and the hype may be difficult for people outside of our industry to discern, so we felt it was important to shed some factual light on this topic.

There is grave danger in allowing misstatements and myths to perpetuate, and I hope that we have been able to clear up some of the confusion here. The escalation of misconceptions currently being witnessed is alarming. We need to take a deep breath, look around, and realize that things in the secondary trading markets may not be as broken as they are currently made out to be. Evolving regulatory rule-making and oversight is good (I say even vital), and we should let the regulatory process work as it was intended. Otherwise we could find ourselves dealing with the unintended consequences of snap reactions, and possibly make things worse rather than better.

Sincerely,
Joe Ratterman

Chairman, President and CEO
BATS ... Making Markets Better