January 21, 2016

VIA E-MAIL

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

RE: Response to Comment Letters, Securities Exchange Act Release No. 76470; File No. SR-BATS-2015-101 as modified by Amendment 1

Dear Mr. Fields:

BATS Exchange, Inc. ("BATS" or "Exchange") appreciates the opportunity to respond to comment letters submitted in connection with SEC Release No. 34-76470; File No. SR-BATS-2015-101 as modified by Amendment 1 ("Revised Proposal"). For the reasons set forth in SEC Release No. 34-75693; File No. SR-BATS-2015-57 as modified by Amendment 1 ("Initial Proposal"), the Revised Proposal, the Exchange's response to the comments on the Initial proposal, and this letter, the Exchange believes that the Revised Proposal to adopt proposed Rules 8.17 and 12.15 is consistent with Section 6(b)(5) of the Securities Exchange Act of 1934 ("Act").[1] The Exchange therefore respectfully requests that the Securities and Exchange Commission ("Commission") approve the Revised Proposal.

I. Background

A. The Exchange Seeks To Protect Market Participants From Continued Harm During Investigation And Enforcement Of Violations

As explained in the Initial Proposal, as a national securities exchange, the Exchange is required to be organized and to have the capacity to enforce compliance by its Members and persons associated with its Members, with the Act, the rules and regulations thereunder, and the Exchange's Rules.[2] The Exchange's Rules are required to be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade … and, in general, to protect investors and the public interest."[3] To fulfill these requirements, the Exchange has developed a comprehensive regulatory program that includes surveillance of

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[1] 15 U.S.C. 78f(b)(5).

[2] 15 U.S.C. 78f(b)(1).

[3] 15 U.S.C. 78f(b)(5).

trading activity that is both operated by Exchange staff and by staff of the Financial Industry Regulatory Authority ("FINRA") pursuant to a Regulatory Services Agreement ("RSA"). When disruptive or potentially manipulative or improper quoting and trading activity is identified, the Exchange or FINRA (acting as an agent of the Exchange) conducts an investigation into the activity, requesting additional information from the Member or Members involved. To the extent violations of the Act, the rules and regulations thereunder, or Exchange Rules have been identified and confirmed, the Exchange or FINRA as its agent will commence the enforcement process, which might result in, among other things, a censure, a requirement to take certain remedial actions, one or more restrictions on future business activities, a monetary fine, or even a temporary or permanent ban from the securities industry.

Regulatory enforcement takes time, however. Due to the often complex nature of disruptive and potentially manipulative improper quoting and trading activity and the gravity of the potential remedial actions at the Exchange's disposal, the Exchange believes it is generally necessary to thoroughly investigate potential violations and provide adequate due process to the subject Member during enforcement proceedings. The Exchange has observed, however, 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 simple – and oftentimes brazen – cases of improper behavior are afforded the same thorough process as more nuanced cases of possible disruptive behavior that is potentially defensible. As a result, a rogue Member – or in many instances, the Member's clients – are effectively permitted to continue illegal, disruptive behavior that harms the market and its participants pending the completion of the lengthy investigation and enforcement process. Currently, the Exchange stands helpless to protect market participants pending a final resolution of the enforcement process.

Not only does the Exchange believe that this result is unacceptable, but as a registered national securities exchange it has the explicit obligation to "prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade … and, in general, to protect investors and the public interest."[4] To fulfill this obligation, the Exchange has proposed to specifically define and prohibit the most egregious cases of layering and spoofing[5] and to provide the Exchange with an expedited hearing process in which a Member who continuously violates the prohibition or continues to permit its client to violate the prohibition can be suspended in a matter of weeks rather than years. The suspension is designed to remain in place for only as long as necessary to cause a Member to cease and desist illegal layering and/or spoofing practices. If a Member is suspended under the proposed Rule, the Member is permitted to apply via an expedited process to have the order modified, set aside, limited, or revoked at any time after the Member is served with a suspension order. The Exchange believes this procedure appropriately places the burden on the offending Member to show that it has halted its harmful practice or its client's harmful practice before being permitted to resume activity on the

[4] 15 U.S.C. 78f(b)(5).

[5] The Exchange notes that all instances of layering and spoofing are already prohibited by the broader proscription of 17 C.F.R. 240.10b-5 against deceptive and manipulative practices.

Exchange rather than requiring the market to bear the harm of continued manipulative conduct until the Exchange finally disposes of the Member's case.

B. The Initial Proposal

Under initial proposed Rule 8.17, the Exchange proposed to establish expedited procedures for issuing suspension orders, immediately prohibiting a Member from conducting continued layering or spoofing activity on the Exchange and establishing the procedures to permit the Exchange to order a Member cease and desist providing a client of the Member access to the Exchange when the client of the Member is conducting layering or spoofing activity in violation of proposed Rule 12.15. The definitions of prohibited "Layering" and "Spoofing" contained in Rule 12.15 were designed to encompass conduct the Exchange has observed in the most egregious layering and spoofing cases. Proposed Rule 12.15 prohibited "Layering" and "Spoofing" as follows:

> 12.15 Layering and Spoofing Prohibited
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> No member shall engage in or facilitate layering or spoofing activity on the Exchange, as described in Interpretation and Policy .01 of this Rule, including acting in concert with other persons to effect such activity.
>
> *Interpretations and Policies*
>
> .01 Layering. For purposes of this Rule, layering activity shall include a frequent pattern in which the following facts are present:
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> (a) a party enters multiple limit orders on one side of the market at various price levels (the "Layering Orders"); and
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> (b) following the entry of the Layering Orders, the level of supply and demand for the security changes; and
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> (c) the party enters one or more orders on the opposite side of the market of the Layering Orders (the "Contra-Side Orders") that are subsequently executed; and
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> (d) following the execution of the Contra-Side Orders, the party cancels the Layering Orders.
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> .02 Spoofing. For purposes of this Rule, spoofing activity shall include a frequent pattern in which the following facts are present:
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> (a) a party narrows the spread for a security by placing an order inside the NBBO (the "Spoofing Order"); and

(b) the party then submits an order on the opposite side of the market ("Contra-Side Order") that executes against another market participant that joined the new inside market established by the Spoofing Order.

.03 Applicability. For purposes of this Rule, layering activity and spoofing activity shall include a frequent pattern in which the facts listed above are present. Unless otherwise indicated, the order of the events indicating the pattern does not modify the applicability of the Rule. Further, layering activity and spoofing activity includes a pattern or practice in which all of the layering or spoofing activity is conducted on the Exchange as well as a pattern or practice in which some portion of thee layering or spoofing activity is conducted on the Exchange and the other portions of the layering or spoofing activity is conducted on one or more other exchanges.

Knowing that proposed Rule 12.15 defines typically the most egregious patterns of layering or spoofing, proposed Rule 8.17 provides an expedited suspension hearing process to halt continuing violations. A Member who is accused of a violation or whose client(s) is accused of a violation ("Subject Member") is provided notice requesting that the Subject Member either take action or refrain from action and a detailed statement of facts to support the allegations of a violation of Rule 12.15 signed by a person with knowledge of the factual allegations. Rule 8.17 then provides for the expedited appointment of a hearing panel and a procedure by which the Subject Member may move to disqualify a member of the hearing panel. The Subject Member then must be served with a notice of hearing not later than 7 days before the hearing. The hearing shall take place not less than 15 days after the initiation of suspension proceedings under Rule 8.17. After the hearing, the hearing panel must issue a written decision stating whether a suspension order shall be imposed not later than 10 days after the panel receives the hearing transcript. Under Rule 8.17, a suspension order shall be imposed if the Hearing Panel finds:

(a) by a preponderance of the evidence that the alleged violation specified in the notice has occurred; and

(b) that the violative conduct or continuation thereof is likely to result in significant market disruption or other significant harm to investors.

If the hearing panel imposes a suspension order, the order shall (1) set forth the alleged violation and the significant market disruption or other significant harm to investors that is likely to result without the issuance of an order, (2) describe in reasonable detail the act or acts the Subject Member is to take or refrain from taking, and (3) include the date and hour of the order's issuance. A suspension order under Rule 8.17 shall be limited to ordering the Subject Member cease and desist from violating Rule 12.15 and/or providing access to the Exchange to a client of the Subject Member that is causing violations of Rule 12.15. The Initial Proposal also provides sanctions for the Subject Member's violation of a suspension order.

The Initial Proposal provides that any sanction imposed pursuant to proposed Rule 8.17 is final and immediately effective. The proposed Rule dictates that the filing of an application for review with the SEC does not stay any sanction imposed under the rule unless the SEC orders otherwise. Finally, the proposed Rule permits the Subject Member who is served with a suspension order to apply to the Hearing Panel to request the order be modified, set aside, limited, or revoked. The Hearing Panel must provide an expedited response to the application within ten days.

C. Withdrawal And Revision Of The Initial Proposal

Five Comment Letters were submitted to the Commission by four different commenters in response to the Initial Proposal. *See* Letters from Samuel F. Lek, Chief Executive Officer, Lek Securities Corporation, dated September 3, 2015 and September 18, 2015 ("Lek Letter I" and "Lek Letter II," respectively), Letter from R.T. Leuchtkafer, dated September 4, 2015 ("Leuchtkafer Letter I"), Letter from FIA Principal Traders Group, dated September 9, 2015 ("FIA PTG Letter"), and Comment from Teresa B. Machado, dated August 19, 2015 ("Machado Comment") (collectively, the "Initial Proposal Comment Letters"). The Exchange responded to the Initial Proposal Comment Letters on November 6, 2015. ("Initial Comment Response").

FIA PTG and Lek voiced concerns that non-spoofing and non-layering activity could conceivably fall within the definitions of "Layering" and "Spoofing" in the Initial Proposal because the definitions did not contain an express intent element. Leuchtkafer, on the other hand, argued manipulative layering and spoofing activity could conceivably fall outside the proposed definitions.

The Exchange explained in its Initial Comment Response that the most prominent indicium of manipulative intent is included in proposed Rule 12.15 – a frequent pattern of manipulative activity. This ensures that legitimate trading practices are not prohibited. Further, in response to FIA PTG, Lek, and Leuchtkafer, the Exchange explained that the proposed rule is a prophylactic rule designed to protect market participants from manipulative trading practices while the Exchange undertakes the lengthy process of proving subjective intent in the ultimate formal enforcement action. The Rule is not intended to provide a universal definition of layering and spoofing. It is the Exchange's position that layering and spoofing are already prohibited illegal practices and, therefore, a repetitive universal prohibition is unnecessary at this time.

Since the purpose of proposed Rules 8.17 and 12.15 is not to provide a precise definition of layering and spoofing but instead to protect market participants from the harm caused by a Subject Member's refusal to cease obvious disruptive market practices, the Exchange has modified the defined terms in proposed Rule 12.15 in the Revised Proposal. The defined term, "Layering," in initial Proposed Rule 12.15 is now labeled "Disruptive Quoting and Trading Activity Type 1." The defined term, "Spoofing," in the initial Proposed Rule is now labeled

"Disruptive Quoting and Trading Activity Type 2." The Revised Proposal also updates the terminology in Rules 8.17 and 12.15 to reflect the revised terminology of Rule 12.15.[6]

Finally, the proposal will not supplant the Exchange's current investigative and enforcement process. Currently, when Exchange surveillance staff identifies a pattern of potentially disruptive quoting and trading activity, the staff conducts an initial analysis and investigation of that activity. After the initial investigation, the Exchange then contacts the Member responsible for the orders that caused the activity to request an explanation of the activity as well as any additional relevant information, including the source of the activity. The Exchange will continue this practice if the proposal is approved. The Exchange will only seek an expedited suspension when – after multiple requests to a Member for an explanation of activity – it continues to see the same pattern of manipulation from the same Member and the source of the activity is the same or has been previously identified as a frequent source of disruptive quoting and trading activity.

II. Comment Letters On The Revised Proposal And Response

The Exchange received four additional comments on the Revised Proposal. *See* December 15, 2015 Memorandum regarding Recommendation of the Investor Advocate, Richard Fleming ("OIA Recommendation"); December 14, 2015 Letter from R.T. Leuchtkafer ("Leuchtkafer Letter II"); December 30, 2015 Letter from G.T. Spaulding ("Spaulding Letter"); December 28, 2015 Letter from Samuel F. Lek, Chief Executive Officer of Lek Securities Corporation ("Lek Letter III"). The Exchange appreciates the Securities and Exchange Commission Office of the Investor Advocate's ("OIA") support of its proposal. The Exchange also appreciates Leuchtkafer's, Spaulding's, and Lek's critiques of the proposal. As explained below, however, the Exchange believes these critiques are largely unsubstantiated and should not delay the Commission's approval of the proposal.

A. Recommendation Memorandum Of Rick Fleming, Investor Advocate, U.S. Securities And Exchange Commission

The OIA supports the proposal and recommends that the Commission approve it:

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[6] In the Revised Proposal, the Exchange also removes subparagraph (f) of proposed Rule 8.17 contained in the Initial Proposal. Subparagraph (f) provided a process for sanctioning violations of a suspension order. It is the Exchange's position that a suspension order issued under Rule 8.17 is enforceable against the Subject Member and no additional process is required to discipline the violation of an order, thereby making subparagraph (f) of proposed Rule 8.17 in the Initial Proposal superfluous. Finally, the Revised proposal modifies subparagraph (d)(2)(A) of proposed Rule 8.17 to clarify that a suspension order is to order that a Member served with such order is suspended from access to the Exchange unless and until the Member complies with the cease and desist provisions of the order.

> [W]e urge the Commission to approve the proposal. We commend the Exchange for its leadership in crafting a proposal to quickly address obvious disruptive and manipulative behavior that would otherwise expose investors to significant and ongoing potential harm, and we would welcome similar efforts by other SROs, including the three other exchanges operated by BATS Global Markets, Inc., to expedite their regulatory process when clear evidence of manipulative trading is identified.

The OIA agrees that the proposal "easily satisfies" the requirements for rules of a national securities exchange:

> The Exchange Act requires that the rules of a national securities exchange be designed, in relevant part, to: prevent fraudulent and manipulative acts and practices; promote just and equitable principles of trade; foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, protect investors and the public interest. *In our view, the proposed rules easily satisfy these fundamental requirements because they are designed to stop manipulative trading activity, including disruptive quoting and trading activity containing many of the elements indicative of spoofing and layering.*

Finally, the OIA correctly notes that the proposed expedited suspension process is intended to be used sparingly as a deterrent force – supplementing rather than replacing the current enforcement process:

> We hope that the adoption of the Exchange's rule will help to obviate the need for its application. The proposed expedited process rule should act as a deterrent to U.S. broker-dealers that would otherwise permit manipulators to continue to access U.S. markets during the course of an enforcement proceeding. Under expedited suspension procedures, such U.S. broker-dealers will no longer have an expectation of a lengthy period in which to continue to receive revenue through facilitating the trading activity of manipulative clients.

The Exchange thanks the OIA for its recommendation and its support in combating continued disruptive manipulative behavior.

B. R.T. Leuchtkafer And G.T. Spaulding, Anonymous

With the support of the OIA, we now turn to the letters of the anonymous commenters writing under the pseudonyms, "R.T. Leutchkafer" and "G.T. Spaulding."

1. The Proposal Is An Objective Tool To Combat Continued Principles-Based Violations

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 …."[7] 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.[8]

As to why Leuchtkafer has not been able to find more "press accounts" of the Exchange investigating and enforcing layering and spoofing conduct, that is because the investigation to prove "principles-based" violations is lengthy due to the fact that the enforcement of those violations require proof of subjective fraudulent intent of the actor. This subjective intent is usually very difficult to prove and requires a thorough and lengthy investigation and enforcement process. In the meantime, the Exchange does not have the ability to stop obvious and flagrant manipulative trading.

The proposed Rules are designed to change this – to allow the Exchange to take swift action to stop flagrant manipulation pending investigation and enforcement. If proposed Rules 8.17 and 12.15 are ultimately approved and implemented, the Exchange will continue conducting its current enforcement process. The proposal, however, allows the Exchange to initiate an expedited suspension proceeding after the Exchange continues to see the same frequent pattern of manipulation from the same source through the same member even after the Exchange has alerted a Member of the suspect activity.

Leuchtkafer, however, takes issue with the objective criteria set forth in proposed Rule 12.15 because he contends it is not "principles-based." In other words, the rule looks to objective criteria rather than subjectively evaluating conduct to determine if it is violative.

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[7] Additionally, Leuchtkafer criticizes the Exchange for failing to detect spoofing in the futures markets in the Navinder Singh Sarao case and spoofing in the commodities markets in the Michael Coscia case – however, the Exchange does not operate futures or commodities exchanges.

[8] BATS Exchange, Inc. v. Hold Brothers Online Investment Services LLC, Letter of Acceptance, Waiver and Consent, No. 20100243992 (2012), *available at*: http://cdn.batstrading.com/resources/regulation/disciplinary/2012/No_20100001.pdf; BATS Exchange, Inc. v. Biremis Corp., Letter of Acceptance, Waiver and Consent, No. 20100222215-01 (2012), *available at*: http://cdn.batstrading.com/resources/regulation/disciplinary/2012/No_20100222215-01.pdf.

Leuchtkafer advocates that the Exchange *must* adopt "principles-based" language *instead* of the Exchange's current proposal.[9]

As explained in the Initial Comment Response, there are already principles-based prohibitions against layering and spoofing that the Exchange is charged with enforcing, including Sections 10(b) of the Act and Rule 10b-5 promulgated thereunder.[10] The Exchange believes that the proposal will be an effective supplement to existing principles-based prohibitions and to protect market participants while bringing principles-based enforcement actions. Principles-based enforcement and the proposed Rules are not mutually exclusive. In practice, they are complimentary.[11]

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[9] Leuchtkafer favors IEX's prohibition of layering and spoofing: "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." IEX Rule 10.110(b)(1). While the Exchange agrees that IEX's definition describes layering and spoofing – the Exchange included conceptually similar definitions in its Statement of Purpose of both the Initial Proposal and the Revised Proposal – Leuchtkafer's advocacy for that definition to replace Exchange's proposed rule text misses the proposal's purpose. Defining layering and spoofing in all of its possible permutations is not the purpose of this filing. Instead, the Exchange intends to supplement existing prohibitions against layering and spoofing with an expedited objective prohibition that will stop harmful manipulative activity while the Exchange conducts necessary extensive and time-consuming investigations and enforcement. Even IEX's prohibition suffers from the same infirmities as the current process – it is conditioned upon a finding of subjective intent. When IEX becomes a registered exchange, it will likely run into the same difficulties with stopping manipulative practices on its exchange pending the lengthy investigation and enforcement process without running afoul of fair access rules. Perhaps IEX will consider adopting a similar proposal as encouraged by the OIA. Regardless, principles-based prohibitions can only benefit from an expedited objective prohibition to quickly halt disruptive trading practices during the principles-based investigation.

[10] *See* Order Instituting Administrative Cease and Desist Proceedings, *In re Afshar, et al*, *available at*: http://www.sec.gov/litigation/admin/2015/33-9983.pdf; *see also* Section 9(a)(2) of the Act.

[11] The OIA understands and endorses this principle:

> We would welcome and encourage the development of policies and practices designed to prevent or discourage disruptive and manipulative trading from occurring in the first place. *We recognize, however, that bad actors may always find ways to engage in manipulative behavior in the securities market. In light of that reality, the next best alternative is to expeditiously terminate manipulators' access to the market once the behavior is identified.*

OIA Recommendation at 4-5.

2. Leuchtkafer's And Spaulding's Complaints Are Not Directed At The Exchange

Much like in his first comment letter, Leuchtkafer spends much of his second letter expressing his views on the statements of others – namely Remco Lenterman, retired senior executive of IMC Financial Markets and Hudson River Trading ("HRT") – rather than addressing the proposal at hand. Similarly, the anonymous G.T. Spaulding echoes Leuchtkafer regarding Mr. Lenterman's social media posts. The Exchange believes that the comments about Mr. Lenterman and HRT are irrelevant to the proposal. The Exchange, therefore, will limit its response to comments addressing the proposal.

C. Samuel Lek, Lek Securities Corporation

Finally, Samuel Lek submits a third comment letter on the proposal and essentially repeats the same complaints he made in his two previous comment letters. Notably Lek continues to defend the disruptive conduct the Exchange seeks to eliminate as merely a "competitive" trading strategy.

Of course, U.S. regulators and prosecutors disagree as demonstrated by the SEC's spoofing enforcement action against Afshar *et al.*, and by the criminal conviction of Michael Cosica for spoofing on the commodities markets. Market manipulation is not acceptable "competitive" conduct and the Exchange will not stand for it on its market.

As for Lek's hypotheticals involving a single instance of trading conduct, none of those hypotheticals would violate Rule 12.15 because single instances are not "frequent patterns." There is no risk that Rules 12.15 and 8.17 could be used to prohibit an isolated series of coincidental transactions. If a frequent pattern of that activity arises, however, it is likely manipulative and will violate proposed Rule 12.15.

The remaining complaints of Lek's third comment letter are duplicative of his first and second comment letters, and the Exchange incorporates by reference its Initial Comment Response.

III. Conclusion

For the foregoing reasons, and with the approval recommendation of the OIA, the Exchange respectfully requests the Commission approve the Revised Proposal.

Very truly yours,

Anders Franzon
SVP Associate General Counsel

cc: Stephen Luparello, Director, Division of Trading & Markets
David Shillman, Associate Director, Division of Trading & Markets
David Liu, Senior Special Counsel, Division of Trading & Markets