



## Of BOLTs and Flashes

On June 4<sup>th</sup> and June 5<sup>th</sup>, Nasdaq Stock Market and BATS Exchange respectively rolled out innovative new order types. Nasdaq's Flash and BATS' BOLT (BATS Optional Liquidity Technology) order type are similar in that liquidity in the order, priced at the inside of the NBBO on the opposite side of the market, is made available via a broadcast to exchange members for a random period up to half a second before it either cancels or is subsequently made available to the public markets.

The release of these orders immediately caught the attention of the industry, prompting letters to the Securities and Exchange Commission (SEC) from NYSE Euronext and the Securities Industry and Financial Markets Association (SIFMA) challenging the prudence, if not the legality, of allowing these orders. Citing the Direct Edge Enhanced Liquidity Provider (ELP) program and similar (though not identical) order handling procedures in use for some time at the CBOE Stock Exchange, the letters implore the SEC to deny or at least suspend implementation of these orders and begin a broad discourse on market structure as it pertains to displayed and non-displayed liquidity.

The NYSE Euronext and SIFMA comment letters provide a litany of reasons for the SEC to disallow flash orders including that they raise substantive technology, compliance and best execution issues; that they negatively impact investor protection and the public interest; that they place significant burden on the competition; and that they "impede a free and open market system and harms the investing public".

Our view on the acceptability of flash orders is related to their degree of use. Limited to a few venues, selectively used, and not representative of a substantial portion of overall order flow, these orders should pose no significant threat to overall market structure. However, offered by market centers whose collective share volume represents a majority of order flow they would likely have an undesirable impact.

Offered by a limited number of trading venues, flash orders offer choice to the trading community. Traders using marketable limit orders may well find it in their interest to have an opportunity to receive a rebate on at least part of an order while receiving market price in the security. It is true that a flash order might no longer be marketable once released to the public markets after the flash period and may not fill. There are also best execution implications, though not all negative as put forth by NYSE Euronext in their comment letter. Order selection and fiduciary responsibility rest with the trader so it would be incumbent upon the user to understand how the order works.

To the extent contra side traders consider themselves disadvantaged, there exists the opportunity to become a member of one or more of the venues offering flash orders if a broker/dealer (fairly straightforward at both BATS Exchange and Nasdaq Stock Market) or to utilize a broker with appropriate memberships if a buy side institution or retail trader. Contra side traders could display as they would otherwise but cancel displayed orders if they fill through flashed liquidity. Unlike trade-throughs that tend to drive displayed liquidity from the overall market, flashed orders are more likely to redistribute some of the order flow among market centers.

# Woodbine *Opinion*

Views on Issues Impacting the Capital Markets by the Analysts of Woodbine Associates



June 30, 2009

If flash orders proliferated to the group of market centers comprising a majority of displayed liquidity and usage increased, there may be undesired effects on the overall market. In this case, most marketable liquidity would be briefly held across a larger number of trading venues. The market would fragment even further and filling the contra side displayed order in the public market would, no doubt, become more difficult. This would likely lead to wider overall spreads.

Unfortunately, we do not have the answer as to the point flash orders become detrimental to the overall market. Markets are complicated and it is often not possible to determine the impact of an innovation or regulation without implementation. Accordingly, we believe it in the best interest of the market that the SEC allow flash orders, monitor their use, and study the effect on the market. Such an approach will provide market participants with the greatest degree of latitude on how to execute orders, curtailing activity only once determined detrimental. This has been the approach taken by the SEC since the 1970s and it has preserved innovative spirit in the securities market.

Woodbine Associates encourages you to learn more about flash orders. Click [here](#) to see Nasdaq's filing with the SEC; [here](#) to see BATS filing with the SEC; [here](#) to see the NYSE Euronext comment letter; and, [here](#) to see the SIFMA comment letter.

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