



BATS November Newsletter: Options Update

Dear Members and Prospective Members,

Recent months have seen the births of a handful of new markets – two US options exchanges and two US equity exchanges, plus Direct Edge converted both of its venues to exchange status. Well, BATS Options isn't quite "new", since we completed the roll out in June, but it still feels new to me. Every new exchange faces the challenge of attracting and growing a pool of liquidity to one with critical mass and sustainability. For new exchanges, this must be grown from scratch and even a natural community of users is no guarantee of success.

With BATS Options, we have not inverted pricing on the order book yet. Rather, since October we've been encouraging BATS Options members to access away exchange liquidity via our SOR while maintaining a simple fee schedule with a \$.20 rebate and a \$.30 charge per contract matched on BATS. In effect we're saying, "Give us 'first look' at your marketable customer orders, and if we can't match them on our order book, we'll cut your cost to remove liquidity elsewhere."

Now, it is tough to beat payment for order flow arrangements, but given the continued growth of maker-taker pricing among the options exchanges and the wide range of fees charged, **our simple, aggressive approach to routing resonates with members.** The average number of members on the tape each day with BATS Options has grown more than 30% since introducing the pricing in October. Moreover, those members taking advantage of our routing have quickly evolved from using BATS+ order types, which scrape BATS then are routed to one other requested market, to relying on our smart order handling and parallel routing capabilities – a unique feature among options exchanges.

However, it is not enough, and we can do more still. BATS did not start an options exchange to run an options routing business. In the month of October, we routed away more volume than we matched. In the month of November, we've seen positive movement, with our matched vs. routed percentage climbing by almost 10% on average. There are phenomenal opportunities to interact with this pass-through liquidity on BATS. If you haven't investigated the opportunities yet, please reach out to your sales director or our trade desk (tradedesk@batstrading.com) and get on the subscription list for our intraday volume report. With the valuable insight from this report, take a look and see what you're missing.

As a final note on options pricing, *we have innovative ideas for pricing in the coming year, so stay tuned.*

Making Markets Better – More Than a Tag Line

On a daily basis, I have seen the differences and similarities between the options and equity markets front and center. Every time we take a step forward in the options markets – and yes, I do consider them steps forward – whether it be the expansion of pennies, or the industry’s one-year-old Locked and Crossed Market Plan – the differences are diminishing. As we enter the holiday season of 2010, those remaining differences are top of mind for me on two fronts:

First is the need to resurrect the flash order debate. After months of public outcry, the Commission first proposed eliminating flash orders and step-up mechanisms all the way back in September 2009. It has been seven months since they posed a number of additional questions on the topic specifically related to the options markets. Concern is growing that these once heated issues are becoming less urgent topics for debate and rulemaking at the Commission. The questionable market practices of step-up and flash orders must not be forgotten and need to be addressed. Changing a name on an order type and including the terms “price improvement” does not mean the order type behavior changed and is now better for market structure.

Bottom line: step-ups do not incent market makers to post their best bids and offers. With current step-ups, a select number of liquidity providers get a free look; they have the ability to match the locking order (or NBBO) at an away market price when that order is flashed. The responding liquidity provider does not have to be exposed or at risk to respond to a step-up auction. **It is poor market structure.** The end of the debate is not yet in sight – more comments were submitted to the Commission in September and October. It is time to bring the issue to a close. That would be something to be truly thankful for.

Second, BATS has recently filed with the SEC a proposal for innovative functionality with directed orders in our price-time options market. Our directed order functionality has the potential to move the options markets forward in a powerful way by allowing our members to preference who they interact with while maintaining price-time priority with potential price improvement. We think this will open to our members an important aspect of how participants compete and interact on the classic exchanges. More importantly, and in direct contrast to flash orders, we’re putting in place a powerful set of incentives. We expect to see more price improvement, and a greater contribution to price and size discovery by our members.

Another part of our recent filing with the SEC allows for option orders to be priced at the midpoint of the NBBO, while displayed at the NBBO. We’re giving all of our members the ability to tighten the spread while contributing to price and time discovery.

Allowing members to compete and interact in a way that surrounds them with better incentives – that’s Making Markets Better and *even more to be thankful for.*

Wishing you and yours a joyous start to the holiday season.

Sincerely,

Jeromee Johnson

Head of BATS Options and VP, Market Development

BATS ... Making Markets Better