



Regulatory Circular 10-002

Date: February 26, 2010

To: Members of BATS Exchange, Inc. ("BATS Exchange" or the "Exchange")

From: Tamara Schademann, Chief Regulatory Officer

Re: Notice Regarding Approved Changes to Information Barrier Rule, New Rule Regarding Trading Ahead of Research Reports and Guidance Regarding Procedures Related to the Misuse of Material, Non-Public Information – EFFECTIVE IMMEDIATELY

On February 11, 2010, BATS Exchange filed a proposal to amend BATS Rule 5.5, entitled "Information Barrier Procedures" and to adopt new Exchange Rule 12.13, entitled "Trading Ahead of Research Reports." This proposal has been approved by the Securities and Exchange Commission¹ ("Commission") and is effective immediately. The changes to the Exchange's rules are described below, followed by general guidance regarding procedures related to the misuse of material, non-public information. Please note that the change to BATS Rule 5.5 does not affect BATS Rule 22.10, entitled "Limitation on Dealings," which applies to Market Makers on BATS Options.

I. Rule 5.5 "Information Barrier Procedures" has been replaced with Rule 5.5 "Prevention of the Misuse of Material, Non-Public Information"

The Exchange previously prescribed specific information barrier procedures for Members that met the definition in BATS Rule 5.5(a) of a "specialist" and required such firms to file their information barrier procedures with the Exchange. The Exchange has deleted the requirement related to specific information barrier procedures that were required to be maintained and filed with the Exchange. The Exchange has also amended the language that imposes the general standard of preventing the misuse of material, non-public information and added additional language to provide clarity regarding the minimum policies and procedures a Member must implement to comply with such general standards. Pursuant to Rule 5.5, Interpretation and Policy .02, the following minimum policies and procedures must be established, maintained and enforced by all Members of the Exchange:

(1) all associated persons of the Member must be advised in writing of the prohibition against the misuse of material, non-public information;

(2) all associated persons of the Member must sign attestations² affirming their awareness of, and agreement to abide by the aforementioned prohibitions;

¹ Securities Exchange Act Release No. 61574 (February 23, 2010) (SR-BATS-2010-003), *available at*: <http://sec.gov/rules/sro/bats.shtml>.

² These signed attestations must be maintained for at least three years, the first two years in an easily accessible place.

(3) each Member must receive and retain copies of trade confirmations and monthly account statements for each account in which an associated person: has a direct or indirect financial interest or makes investment decisions -- the activity in such brokerage accounts should be reviewed at least quarterly by the Member for the purpose of detecting the possible misuse of material, non-public information; and

(4) all associated persons must disclose to the Member whether they, or any person in whose account they have a direct or indirect financial interest, or make investment decisions, are an officer, director or 10% shareholder in a company whose shares are publicly traded -- any transaction in the stock (or option thereon) of such company shall be reviewed to determine whether the transaction may have involved a misuse of material non-public information.

Maintenance of the foregoing policies and procedures will not, in all cases, satisfy the requirements and intent of this Rule; the adequacy of each Member's policies and procedures will depend upon the nature of such Member's business.

The text of amended Rule 5.5 is included in Exhibit A to this Regulatory Circular. In connection with this change, Members should also review the additional guidance set forth in Section III below.

II. Rule 12.13 "Trading Ahead of Research Reports" has been added to the Exchange's Rules

The Exchange has adopted new Rule 12.13, which (i) prohibits Members from trading ahead of research reports, and (ii) requires each Member to establish, maintain and enforce procedures regarding the flow of information between research department personnel and trading department personnel. The text of new Rule 12.13 is included in Exhibit A to this Regulatory Circular.

III. Additional Guidance Regarding Procedures Related to the Misuse of Material, Non-Public Information

As described above, the Exchange has amended its rules to eliminate certain specific provisions requiring information barriers to be maintained by Members. The Exchange has retained certain, and adopted new, general standards that require procedures to prevent the misuse of material, non-public information. Under amended Rule 5.5, each Member must establish, maintain and enforce written procedures reasonably designed, taking into consideration the nature of such Member's business, to prevent the misuse of material, non-public information by such Member or persons associated with such Member.

As amended, Rule 5.5 provides flexibility to a Member to develop and maintain procedures and controls to prevent the misuse of material, non-public information that are effective and appropriate to that Member. Rule 5.5, Interpretation and Policy .01 provides examples of conduct that would constitute the misuse of material, non-public information.³ Rule 5.5,

³ Such examples include: (a) Trading in any securities issued by a corporation, or in any related securities or related options or other derivative securities, while in possession of material, non-public information concerning that issuer; or (b) Trading in a security or related options or other derivative securities, while in possession of material non-public information concerning imminent transactions in the security or related securities; or (c) Disclosing to another person or entity any material, non-public information involving a corporation whose shares are publicly traded or an imminent transaction in an underlying security or related securities for the purpose of facilitating the possible misuse of such material, non-public information.

Interpretation and Policy .02 sets forth specific policies and procedures that are required of Members, which are explained in detail in Section I above. However, as made clear by the new Interpretation and Policy, the policies and procedures required are only the *minimum* policies and procedures required and will not in all cases, satisfy the requirements and intent of amended BATS Rule 5.5. The adequacy of each Member's policies and procedures depends upon the nature of such Member's business.

Pursuant to the rule change, Members may utilize a flexible, principles-based approach to modify their policies and procedures as appropriate to reflect changes to their business model, business activities, or to the securities market itself. A Member should be proactive in assuring that its policies and procedures reflect the current state of its business and continue to be reasonably designed to achieve compliance with applicable federal securities law and regulations, and with applicable Exchange rules. While information barriers are not specifically required under the amended rules, a Member's business model or business activities may dictate that an information barrier or a functional separation be part of the appropriate set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities law and regulations, and with applicable Exchange rules.

As approved, the only specific information barrier requirement of the Exchange is the requirement of Rule 12.13, described in Section II above, to maintain policies and procedures reasonably designed to restrict or limit the information flow between those with knowledge of the content or timing of a research report and trading department personnel. However, the Exchange does not intend to indicate that information barriers may not be necessary for Members in other contexts. To the contrary, information barrier procedures may be a necessary or effective means to manage conflicts of interest or to prevent communications of material non-public information between certain individuals or groups.

The Exchange, through this Regulatory Circular, hereby adopts and incorporates by reference:

- (1) **FINRA Regulatory Notice 07-59** (December 2007), which provides specific guidance regarding the review and supervision of electronic communications, including topics that are relevant to the maintenance and supervision of an information barrier;⁴ and
- (2) **NASD Notice to members 91-45** (June 28, 1991), which provides specific guidance regarding the minimum elements of adequate information barrier policies and procedures pursuant to the requirements of the Insider Trading and Securities Fraud Enforcement Act of 1988.⁵

If you have any questions related to this Regulatory Circular, please contact Membership Services at 913.815.7002 or membershipservices@batstrading.com.

A full version of the Exchange's rule filing is available at:
http://www.batstrading.com/res/resources/regulation/rule_filings/approved/2010/SR-BATS-2010-003_approved.pdf.

The Exchange's Rules are available at:
http://www.batstrading.com/resources/regulation/rule_book/BATS_Exchange_Rulebook.pdf.

⁴ Available at: <http://www.finra.org/Industry/Regulation/Notices/2007/P037554>.

⁵ Available at: http://finra.complinet.com/en/display/display_main.html?rbid=2403main.html?rbid=2403&element_id=1182.

Exhibit A – Amended Rule 5.5 and New Rule 12.13

Rule 5.5. Prevention of the Misuse of Material, Non-Public Information

Each Member must establish, maintain and enforce written procedures reasonably designed, taking into consideration the nature of such Member's business, to prevent the misuse of material, non-public information by such Member or persons associated with such Member. Members for whom the Exchange is the Designated Examining Authority ("DEA") that are required to file SEC form X-17A-5 with the Exchange on an annual or more frequent basis must file contemporaneously with the submission for the calendar year end ITSFEA compliance acknowledgements stating that the procedures mandated by this Rule have been established, enforced and maintained. Any Member or associated person of a Member who becomes aware of a possible misuse of material, non-public information must notify the Exchange's Surveillance Department.

Interpretations and Policies

.01 For purposes of this Rule, conduct constituting the misuse of material, non-public information includes, but is not limited to, the following:

- (a) Trading in any securities issued by a corporation, or in any related securities or related options or other derivative securities, while in possession of material, non-public information concerning that issuer; or
- (b) Trading in a security or related options or other derivative securities, while in possession of material non-public information concerning imminent transactions in the security or related securities; or
- (c) Disclosing to another person or entity any material, non-public information involving a corporation whose shares are publicly traded or an imminent transaction in an underlying security or related securities for the purpose of facilitating the possible misuse of such material, non-public information.

.02 This Rule provides that, at a minimum, each Member establish, maintain, and enforce the following policies and procedures:

- (a) All associated persons of the Member must be advised in writing of the prohibition against the misuse of material, non-public information; and
- (b) All associated persons of the Member must sign attestations affirming their awareness of, and agreement to abide by the aforementioned prohibitions. These signed attestations must be maintained for at least three years, the first two years in an easily accessible place; and
- (c) Each Member must receive and retain copies of trade confirmations and monthly account statements for each account in which an associated person: has a direct or indirect financial interest or makes investment decisions. The activity in such brokerage accounts should be reviewed at least quarterly by the Member for the purpose of detecting the possible misuse of material, non-public information; and
- (d) All associated persons must disclose to the Member whether they, or any person in whose account they have a direct or indirect financial interest, or make investment decisions,

are an officer, director or 10% shareholder in a company whose shares are publicly traded. Any transaction in the stock (or option thereon) of such company shall be reviewed to determine whether the transaction may have involved a misuse of material non-public information.

Maintenance of the foregoing policies and procedures will not, in all cases, satisfy the requirements and intent of this Rule; the adequacy of each Member's policies and procedures will depend upon the nature of such Member's business.

Rule 12.13. Trading Ahead of Research Reports

(a) No Member shall establish, increase, decrease or liquidate an inventory position in a security or a derivative of such security based on non-public advance knowledge of the content or timing of a research report in that security.

(b) Members must establish, maintain and enforce policies and procedures reasonably designed to restrict or limit the information flow between research department personnel, or other persons with knowledge of the content or timing of a research report, and trading department personnel, so as to prevent trading department personnel from utilizing non-public advance knowledge of the issuance or content of a research report for the benefit of the Member or any other person.