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August 10, 2010

Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Elimination of Flash Order Exception from Rule 602 of Regulation NMS; Release No. 34-62445 (File No. S7-21-09)

Proposed Amendments to Rule 610 of Regulation NMS; Release No. 34-61902 (File No. S7-09-10)

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Dear Ms. Murphy:

Global Electronic Trading Company ("GETCO") appreciates the opportunity to comment on the Securities and Exchange Commission's proposal to eliminate the use of flash orders in the listed options market. GETCO has consistently opposed the use of flash or step-up orders in both the cash equity and options markets and supports the Commission's proposal to amend Rule 602 of Regulation NMS.[1] We note that the recent reopening of the comment period is solely with respect to eliminating the flash order exception with respect to listed options. GETCO believes strongly, however, that the concerns raised by flash orders are the same regardless of the market and, therefore, there is no basis to differentiate between the cash equity and options markets in this regard.

I. Introduction

GETCO is a leading electronic trading and technology firm providing liquidity on over 50 markets in North and South America, Europe, and Asia. We are a registered market maker on various equity and option exchanges and a Designated Market Maker (DMM) and Supplemental Liquidity Provider ("SLP") on the New York Stock

1 *See* Letter to Elizabeth Murphy, Secretary, Securities and Exchange Commission (November 23, 2009) (comment letter on proposal to eliminate the flash order exception in Rule 602 of Regulation NMS); Letter to Elizabeth Murphy, Secretary, Securities and Exchange Commission (June 4, 2009) (comment on SR-NASDAQ-2009-043); Letter to Elizabeth Murphy, Secretary, Securities and Exchange Commission (June 4, 2009) (comment on SR-BATS-2009-14), Letter to Elizabeth Murphy, Secretary, Securities and Exchange Commission (June 4, 2009) (comment on Direct Edge ECN's ELP Program).

Exchange ("NYSE").[2] From offices in Chicago, New York, London, and Singapore, the firm transacts business in cash and futures products across four asset classes – equities, fixed income, currencies and commodities. We also provide investors with access to dedicated liquidity through an alternative trading system ("ATS"), GETCO Execution Services, or GES. GETCO's primary trading strategy is market making—posting two sided markets—to help investors efficiently transfer the risk commonly associated with assets such as stocks, bonds, commodities and options contracts. Our trading strategies employ advanced technology, real time information, transparent risk management systems and continuous innovation.

II. Discussion Regarding Proposal

A. Flash Orders Reduce Incentives to Display Competitive Quotes

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Flash orders result in wider spreads, which harms customers directly by impairing the quality of the prices they receive on their trades. Flash orders reduce the incentive for market makers to quote aggressively on exchanges that offer the flash order, as well as on exchanges that do not offer flash orders.

- Impact on quote of exchanges offering flash. Market makers on exchanges with flash orders do not need to display competitive quotations to trade with customer orders. Instead, customer orders are routed to the exchange as a result of payment for order flow arrangements. A flash order then allows exchange members to match the quotation displayed by a market maker on another exchange, which (as explained below) is also likely to be less aggressive because of the existence of flash orders.

- Impact on quote of exchanges not offering flash. When some exchanges offer flash orders to their participants, market makers on other exchanges are incented to quote less aggressively for several, related reasons.

  First, the explicit purpose of flash orders is to decrease the likelihood that an order will be routed to a displayed quotation at the best price on another market. By reducing the reward for aggressive quoting, it should not be surprising that flash orders discourage such quotes.

  Second, as the Commission noted in its September 2009 proposal, flash orders at marketable prices undermine the purposes of Rule 601(d) of Regulation

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2 Registered Equity Market Maker: Nasdaq, NYSE Arca, and BATS; Designated Market Maker and Supplemental Liquidity Provider: NYSE; Registered Option Market Maker: Chicago Board Options Exchange, Nasdaq Options Market, BATS Options, and NYSE Arca Options.

NMS and the Options Linkage Plan, which are designed to protect displayed quotations from being locked. Protecting displayed quotations from being locked encourages the display of quotations. GETCO believes that flash orders – which lock publicly disseminated quotations with a private, selectively displayed quotation -- undermine the purpose of the rules against locking markets.

Third, flash orders increase the probability that a displayed quotation will trade with an informed order, which decreases the incentive to display aggressive quotations.[3] Flash orders are more likely to be executed if they are identified as "uninformed" orders. Conversely, flash orders are less likely to be executed if they are not identified as "uninformed" orders. To increase the likelihood that "uninformed" orders are executed in a flash order process, brokers can reveal information about the counterparty of a flash order to potential flash order responders. The absence of information that a flash order is "uninformed" can affect the willingness to trade with the flash order, thus making it more likely that such an order will be routed to a displayed quotation on another market. In this way, revealing counterparty information about a flash order increases the probability that a customer order is an "informed" order if it is routed to a displayed quotation on another market.

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The impact of flash orders on quotations is not theoretical. In early 2008, CBOE began providing its market makers with a $.20 rebate in certain options when they stepped-up to trade in HAL – CBOE's flash order mechanism. The rebate made it less expensive for a market maker to trade in the flash process than to trade by displaying a quotation. In response, we observed quotations widen, which is a rational response by market makers to compensate for the increase in likelihood that displayed quotations would trade with informed orders.

B. Harm to Customer Orders that are Converted to Flash Orders

In addition to the costs imposed on customers by the impact flash orders have on market efficiency, as discussed above, a customer can "miss the market" when its marketable order is converted to a flash order, rather than being routed to the displayed best price. When a customer's marketable order is converted to a flash order, there is the potential that the customer will not be executed in the flash order process and that the better displayed price will no longer be available after the flash process. The better displayed price may no longer be available following the flash order process either because of exogenous market changes or because the information revealed by the flash created an opportunity to front run the customer's order.

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[3] Academic literature supports the notion that market maker quotes are tied to the probability of informed trading. A market maker's quotation, which can be traded against by any market participant, will incorporate the expectation of losses from trades with informed traders and of gains from uninformed traders. *See* Maureen O'Hara, Market Microstructure Theory, (1997), pp 53-88 (analyzing research on information-based models).

The Commission noted that no useful data was provided on how frequently customers "miss the market" when their orders are converted to flash orders. Though GETCO has no data on this issue available to it, we would like to make the following observations:

- Two exchanges that use flash order mechanisms indicated in their comment letters that their fill rates for flash orders were in the range of 60-70%. GETCO believes that the Commission should be concerned about the 30-40% of customer orders that fail to receive an execution of their flash orders. Not only is 30-40% a sizable proportion of any group, the customer orders being converted to flash orders are already selected out in many cases as the least informed orders.

- Flash orders are less likely to be executed when a market is moving away from a price point, which means that the quote on the other market at the beginning of a flash process is likely not to be available after the 30-40% of flash orders that fail to trade in the flash process. Thus, we believe it is likely that the 30-40% of flash orders that are not filled in the flash process also "miss the market."

- Audit trails in both the cash equity and options markets do not capture whether an order was exposed to a flash order process. Thus, it is not possible for the Commission or SROs to surveil for front running or trading ahead of flash orders, or market makers moving their quotes on other markets based on flash orders. The presence of such practices would, of course, increase the likelihood that the 30-40% of flash orders that are not executed in the flash order mechanisms also "miss the market."

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C. Relationship of Flash to Payment for Order Flow and Access Fees

It is impossible to disentangle the flash order mechanisms in the options markets from payment for order flow. Flash orders sustain the payment for order flow arrangements in the options markets by allowing market makers to trade at the NBBO with selected customers without having to display a quote that would be available to all market participants. As discussed above, this creates a dynamic that reduces the quality of the NBBO, harming all investors through worse quotations than there would have been in the absence of flash order mechanisms. In addition, a substantial (though unquantified) proportion of customers may be harmed when they "miss the market."

In its release reopening the comment period on the flash proposal, the Commission noted that, with respect to listed options, those opposing the proposal focused on the differences between the cash equity and listed options markets. In particular, commenters emphasized that, in contrast to the cash equity markets, there is no regulatory cap on the fees charged by listed options exchanges to access their best displayed quotations.

GETCO does not oppose a reasonable cap on access fees – equal to 80-90% of the minimum price variation -- provided such a cap includes all fees for accessing a quotation (e.g., marketing fees, licensing fees, and fees for premium products) and is adopted in conjunction with a ban on flash orders. To limit access fees without banning flash orders would further undermine competitive markets.

We are also concerned about the growing practice by options exchanges of discriminating among market participants in terms of access to quotations. Fair access to each market's quotations is needed for competition among markets to flourish as it has in the cash equity markets. For this reason GETCO supports the Commission's proposal to extend the requirement in Rule 610(a) of Regulation NMS to listed options. We do not believe, however, that this rule would go far enough in restoring fair access to options exchange quotations.

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Fair access to displayed quotations ensures that barriers to competition are low, which is a prerequisite to competitive and efficient markets. The discrimination in access to quotations is most visible in the increasingly differentiated pricing practices by options exchanges – practices that do not exist in the cash equity markets. Exchange fees explicitly favor those market participants who pay for order flow to be directed to an exchange. By charging market participants who did not pay for order flow higher fees, the competitive playing field is not level. These practices have not developed in the cash equity markets and their absence limits the viability of payment for order flow in those markets.

III. Conclusion

GETCO appreciates the opportunity to submit these comments. Please do not hesitate to contact us at (312) 931-2200 if you have questions regarding any of the comments provided in this letter.

Sincerely,

John A. McCarthy
General Counsel