July 19, 2011

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

RE: File Numbers:

RE: Release NMS 34-64547 File Number: 4-631
Dear Ms. Murphy:

Molinete Trading Inc. appreciates the opportunity to comment on the proposed National Market System Plan to Address Extraordinary Market Volatility.

As we noted in our prior letters regarding single stock circuit breakers (http://www.sec.gov/comments/sr-nasdaq-2010-061/nasdaq2010061-2.pdf and http://www.sec.gov/comments/sr-bats-2010-018/bats2010018-1.pdf), trading pauses and halts are better implemented under the NMS structure by application of triggers built off of the national best bid and ask than off of the more error prone last recorded trading price. As such, we are pleased to see the SEC working with the SROs to craft a better plan to address extraordinary market volatility. The plan as written however has material weaknesses and omissions which should be addressed before an implementation or rollout is contemplated.

It is an unfortunate side effect of the competition fostered by the SEC through the creation of the NMS that plans to address market wide constraints on trading are so complex in nature. In adopting new trading rules, all existing NMS and SRO rules, policies and order types need to be checked for edge cases that can arise in conjunction with the new rule. In this release however, many of the edge cases are simply not adequately addressed.

How is the band calculated?

The proposal states that the "Reference Price for each NMS Stock that equals the arithmetic mean price of Eligible Reported Transactions for the NMS stock over the immediately preceding five-minute period". It is not clear whether the trades are weighted by volume, or if this is a strict average of the trade prices reported. If the volume of a transaction is not incorporated into the trading band calculation, then a small number of low volume trades can have an outsized impact on a trading band.

For instance, suppose a relatively illiquid stock has traded 1000 shares over the preceding 5 minutes in 1 trade at $100.00, and is then followed by 10 trades each of 1 share at $96.00.

The weighted average trade price would be $99.96, however a strict arithmetic mean that did not account for trade volume would give an average of $96.96.

In addition to the ambiguity about where a trading band is or should be (due to different calculations of the mean), it might be possible in a non volume-weighted arithmetic mean band to engineer a particular trading band to suit ones needs by purposefully breaking up a large order into smaller orders including many front loaded 1 share odd lot trades with the intent of moving the trading limits in advance of larger transactions.

Which trades can update the trading limits?

It is not clear from the proposal which trades will update the trading limits. Currently, trades made at an ATS report their transactions to the TRF (i.e. without attribution, trades from dark pools do show up on the consolidated tape). Would those trades qualify as trades which would update the arithmetic mean used to calculate price bands?

If ATSs are not subject to the trading band restrictions (i.e. if a dark pool can still transact shares below a lower price band or above the upper price band subject to other NMS restrictions), then what happens to the trades that get reported to the TRF during a trading halt? Would they be used to calculate a new trading band? As the proposal stands right now, it is possible to conclude that ATSs would not need to comply with the limits prescribed, that their trades would be incorporated in limit calculations, and that trades reported to the TRF during a halt would be used to update the new limits since those trades would have happened "over the immediately preceding five-minute period".

What happens if a limit state is never entered due to a market order against an illiquid book?

The proposal states that a limit state is entered "if the National Best Offer equals the Lower Limit Band and does not cross the National Best Bid, or the National Best Bid equals the Upper Limit Band and does not cross the National Best Offer." A trading pause is declared "If trading for an NMS Stock does not exit a Limit State within 15 seconds of entry."

What happens if a lower trading limit is set at $99.00 with a current national best bid of $100.00 and an ISO order sweeps the market to execute against all shares at or above $99.00? Given that the inter-market sweep order priced at $99.00 would not trade "at prices that are below the lower Price Band", it would seem that the trade would be allowed to sweep shares through $99.00 in the current proposal.

However, if all shares bid at or above $99.00 were executed with an ISO order, there would be a jump in the nationally reported best bid to a level below the limit band and no limit state would ever be entered, and in turn no trading halt would be enacted.

Further complicating matters is the proposal that prevents "the display of offers below the Lower Price Band and bids above the Upper Price Band for an NMS Stock. The Processor shall disseminate an offer below the Lower Price Band or bid above the Upper Price Band that may be submitted despite such reasonable policies and procedures, but with an appropriate flag identifying it as non-

executable; provided, however, that any such bid or offer shall not be included in National Best Bid or National Best Offer calculations."

If an ISO order swept shares through and including $99.00, then either no nationally best bid would exist, or that national best bid would be marked as non-executable – even though no limit state or trading halt was entered.

A related case exists in which there never was a bid at $99.00 but all bids equal to or above $99.01 were executed against or cancelled. Once again, no limit state is entered and no pause begun, but there is either no nationally best bid or the nationally best bid is displayed as non-executable.

Conditions for exiting a limit state are not clear

The proposal states that "Trading for an NMS Stock would exit a Limit State if, within 15 seconds of entering the Limit State, the entire size of all Limit State Quotations is executed or cancelled". The term "Limit State Quotations" is not defined in the proposal, but rather conditions in which a quote is simply defined as being a "Limit State Quotation" are given. It is thus unclear under what circumstances all "Limit State Quotations is executed or cancelled". If a bid price band is at $100.00 and 500 shares are bid at $100.00 and those 500 shares are also the national best bid, then it is clear that there is a "Limit State Quotation" for 500 shares. However, if the same 500 shares continue to be bid at $100.00 but a new national best bid of $100.01 is entered on another NMS exchange, it is unclear whether the "Limit State Quotations" have or have not been cancelled. A market participant following either depth of market exchange feeds or the SIP feeds would still see a live order which had previously triggered a "Limit State", but the proposal is vague as to whether or not the continued existence of that order constitutes a continuation of the "Limit State".

Withdrawal from the plan

Section IX of the plan states that "a Participant may withdraw from the Plan, upon obtaining approval from the Commission and upon providing not less than 30 days written notice to the other participants." If a participant withdrew from the plan, then an entire new class of problems would emerge. These include having to determine which quotes the SIP should and should not process, whether a participant still in the plan could route marketable orders to the participants no longer in the plan, and whether a participant not in the plan could route around participants who were in the plan. Withdrawal from the plan will certainly require more than a 30 day period for market participants to adjust systems, and should at a minimum be reviewed for extensive public comment.

Changes in band calculations create more problems

While it is certainly understandable why the proposal would increase trading bands immediately following a halt and for the naturally more volatile open and close of regular trading hours, there are a number of complications that arise from these seemingly small changes to the plan. What happens to an existing halt triggered off of the more restrictive bands when the new bands are calculated at 3:35?

If a trading halt were enacted at 3:34:59 due to a band width of X + 0.01 cents, is it rational to continue to impose the trading halt 1 second later when the band expands to 2X?

The proposal states that "If a Reopening Price does not occur within ten minutes after the beginning of a Trading Pause, the Price Band, for the first 30 seconds following the reopening after that Trading Pause, shall be calculated by applying triple the Percentage Parameters set forth in Appendix A."   What happens if trades occur within the first 30 seconds and price discovery has moved a trading range to between 1.1 and 2.9 times the "Percentage Parameter". Trades take place for 30 seconds, and then the trading band is recalculated to a narrower band potentially halting the stock again.

Each time the trading rules change in a quantum jump, new edge cases are created.

Non display of quotes outside of price bands will exacerbate volatility

The proposal as previously noted requires that "Participants, shall establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for an NMS Stock. The Processor shall disseminate an offer below the Lower Price Band or bid above the Upper Price Band that may be submitted despite such reasonable policies and procedures, but with an appropriate flag identifying it as non-executable; provided, however, that any such bid or offer shall not be included in National Best Bid or National Best Offer calculations."

There are numerous issues associated with this aspect of the plan, including our belief that it will exacerbate volatility in times of stress.

What will the SROs do with respect to orders that fall outside of the limits on their proprietary data feeds? If the commission seeks to prevent the SROs from broadcasting order information on their proprietary feeds, then a number of serious technical problems arise in terms of maintaining time based priority on quotes, generating timestamps for quotes, and more esoteric items such as what happens to an existing order announced by an exchange if the price it is placed at moves from being within the trading bounds to outside (i.e. can the size or price of an existing order now outside of a trading band be modified?).

If the commission believes that the SROs should continue to maintain their order books as they are today (i.e. not filtering out quotes outside of the trading range), then the proposed plan would only further widen the gap in information between those who are able to process the full depth of market data feeds vs. those who use the consolidated feeds, by purposefully filtering out some information.

It is also unclear what the NBBO should look like in times when one or both sides of the NBBO fall outside of the trading range. The proposal simply states that those quotes should not be disseminated, but does not explain what the SIP processor should publish as the NBBO.

If a trading range with a lower bound bid of $100.00 initially had a bid at $100.01 followed by a bid at $99.99 and the order for $100.01 was removed (cancelled or executed), would the NBBO be $100.01, $100.00, $99.99 or $0.00?

What happens to executions at dark pools structured off of the NBBO? How does a broker dealer ensure that a marketable order sent to an internalizer is receiving best execution? What happens to orders pegged to the NBBO mid-point? If mid-point peg orders are intended to be cancelled during a period of an undefined NBBO, then market liquidity that could help prevent a trading halt is being needlessly removed from the marketplace.

Given that many systems may look at the NBBO for performing calculations of fair value, it is in our opinion very dangerous to leave the NBBO undefined, and the commission should only contemplate moving forward with a proposal that clearly identifies what the NBBO would be under all trading conditions.

Beyond needing much more clarification, policies which remove orders from the view of the public can only serve to further induce a liquidity crisis. A market participant seeing orders at $99.99 is much more likely to step into the market with a higher bid at $100.00, than one unable to see any bids at all.

Changes to the SIP data feeds require time for market participants to modify their systems

The CQS and UQDF data feeds are fundamental to the operation of NMS. These data feeds are widely distributed and processed by many different systems.

The proposal should explicitly state the changes made to the CQS and UQDF protocols, so that the public can both review these changes for potential problems, as well as to get feedback from a wide range of market participants about the needed timelines for implementation.

Until the overwhelming majority of current market participants utilizing the CQS and UQDF data feeds are able to modify their systems in line with the needed protocol modifications, a rollout should not be contemplated. 120 days strikes us as far too ambitious of a rollout schedule. Most market participants who would be required to make system changes are likely unaware of any upcoming modifications,and those who are aware that changes will be required are currently unable to get the needed detailed technical information to begin the work.

-Peter Skopp
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