April 21, 2010

Via Email (rule-comments@sec.gov)

Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: Concept Release on Equity Market Structure  
Release No. 34-61358  
File No. S7-02-10 dated January 14, 2010

Dear Ms. Murphy:

Bank of America Merrill Lynch (“BAML”)\(^1\) greatly appreciates the opportunity to provide comments on the Securities and Exchange Commission’s (“SEC”) concept release on equity market structure (“Concept Release”).\(^2\) BAML operates the global markets businesses of Bank of America Corporation (“BAC”), providing securities, strategic advisory and other investment banking services. BAC is one of the world's largest financial institutions, and is actively engaged in facilitating the provision of credit to individual consumers, small and middle market businesses, and large corporations, as well as helping to transfer the risks associated with this credit to end investors. Through its wealth management businesses, it manages over $2.2 trillion in client assets and retains approximately 16,000 financial advisors who serve clients around the world.

BAML fully supports the SEC’s efforts to conduct a thorough review of equity market structure in light of developments in technology, market practices, and regulation since the last assessment. BAML believes that conducting such comprehensive reviews on a periodic basis, which take into account many interrelated issues, allow for a more thorough and thoughtful approach to addressing any potential need for adjustment of the regulatory landscape. As a general statement, however, BAML believes that despite numerous changes in recent years in both market

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structure and participant behavior, the equity market is functioning well today. Even during the severe market duress of late 2008 and early 2009, the technology and processes that support the various trading venues and market participants operated smoothly and effectively. Investors’ equity transactions executed and cleared efficiently, and participants had ready access to liquidity in the market at all times.

BAML believes that the numerous and evolving forms of trading venues that comprise the equity markets, and the trading and market access technology that connects them, provide a healthy environment for innovation and competition to thrive and benefit all investors. It is this diversity that has made the equity markets, and the regulatory regime that supports it, a valuable component to the U.S. capital markets and the economy in general.

While we appreciate the broad scope of the Concept Release, we note that the SEC has asked commenters to focus on three categories of issues: (1) market structure performance; (2) high frequency trading, and (3) undispayed liquidity. We offer the following comments to key questions in these three areas.

I. Market Structure Performance

What are useful metrics for assessing the performance of the current market structure?

BAML believes the order execution quality metrics established under Exchange Act Rule 605, coupled with its companion Rule 606 for order routing disclosure, have been a useful tool in the evolution of equity market structure. The information derived from this disclosure regime provides an important view into execution quality generally, and since its inception in 2000, has led to improved and more consistent execution quality for investors. The rules have resulted in greater competition between brokers for retail-sized order flow, even if most individual retail investors do not themselves review the 605 statistics. Rather, the information generally is valued more by retail brokers, who use the statistics to evaluate the performance of the executing brokers to whom they may route order flow on their customers’ behalf.

BAML further believes, however, that since Rule 605 was implemented approximately ten years ago, there has been significant changes to the technology and metrics employed by brokers and other parties for the benefit of all investors, including academics who may want to analyze the data, in today’s trading environment. As a consequence, BAML believes that execution statistics such as Quoted Spread, Execution Speed, and Realized Spread, among others, should be calculated with reference to finer time stamps (e.g., milliseconds). This would be more useful and accurate in comparing execution quality today, particularly given the growth and reliance upon more technologically-dependent routing and execution processes that must operate in today’s environment of fast-moving quotations, Reg NMS trade-through requirements dependent on such quotations, and the increasing desire of the SEC and other regulators to seek empirical data when assessing important rulemaking initiatives. BAML also does not feel that larger order sizes, (i.e., greater than 10,000 shares), should fall within the scope of these rules because the 10,000 share level has and continues to be the relevant threshold for institutional, not held orders.  

See, e.g., Exchange Act Rules 600(b)(9) and 604(b)(4) of Reg NMS (exception to display requirements); NYSE Rule 92(b) (exception to limitations on members trading because of customer orders); FINRA IM-2110-3 (front running policy); NYSE Rule 127 (block crosses).
In addition, BAML believes that various monthly statistics can be skewed by trading or technology outages, small sample sizes, outliers, or other unusual situations at trading venues. We recommend including metrics that can address this. For example, execution speed metrics could incorporate standard deviation to help illustrate overall speed measurement while dampening what could be the distortive impacts of certain situations.

Furthermore, with respect to trading at the opening or closing of traditional call or auction markets, BAML suggests that Rule 605 encompass some metrics to help compare the execution quality between primary markets, and other, non-primary venues. Establishing metrics that can benchmark off of the primary venue would be extremely useful and could enhance the competition for the handling of that type of order flow in the same way such competition occurs for order flow throughout the trading day.

With respect to including explicit execution costs as part of Rule 605 (i.e., take fees and rebates from venues), BAML does not believe these costs should be taken into account for best execution. Explicit costs take many forms and may not be easily standardized for purposes of Rule 605, and are often addressed through other means of transparency, such as confirmation disclosure, maker-taker price schedules, and the current requirement of Rule 606 to disclose material relationships with trading venues and any profit-sharing or payment for order flow arrangements.

Finally, BAML believes that Rule 605 statistics, as currently formulated, would not make sense for institutional-sized clients’ order flow due to the many different execution instructions that typically accompany large institutional orders. However, BAML would support more standardized calculations for transaction cost analysis (“TCA”) reports to better allow clients to compare TCA reports across brokers on an “apples to apples” basis. For example, when calculating a commonly used statistic such as the arrival price benchmark, there should be a best practice approach on whether to use the midpoint or NBBO as the reference price. Similarly, we suggest standardization of signs for performance (e.g., is a negative value for a particular metric desirable or undesirable). In addition, there should be a consistent approach when calculating performance versus “all day VWAP,” in terms of whether or not to include opening or closing transactions, block prints, and other non-regular way or modified transactions (e.g., .T or .PRP prints).

Are there any current regulations that are harming or preventing more efficient market quality?

As discussed below in the section on high-speed trading, BAML believes that the slowness of the consolidated tape impacts the data against which key business and regulatory performance is measured, such as best execution, short sale compliance, ISO routing and trade through compliance. Given the increasing time lag of the consolidated data to the real-time pace of trading in the markets, the consolidated tape may be outliving its usefulness as the proper regulatory reference point.

II. High Speed Trading; Co-Location

Does co-location give proprietary trading firms an unfair advantage because they may have greater resources and sophistication to take advantage of co-location services as compared to other market participants, including long term investors? Does co-location harm or help long term investors?
BAML generally believes that co-location is the latest iteration of the longstanding effort to move closer to the point of sale, in much the same way that brokerage “wire houses” transitioned to be more closely connected to the markets in which they maintained memberships. In virtually all respects, the trend toward greater co-location is consistent with the five principle objectives set forth by Congress in Section 11A of the Exchange Act and should not be unnecessarily discouraged. Co-location encourages all firms (proprietary traders as well as brokers representing retail and institutional customers) to continuously examine and enhance available and competing execution platforms. These innovations and enhancements lead to faster, more efficient executions for all investors, on both sides of the market and regardless of whether they are short or long term investors. In addition, co-location provides a level playing field for firms that are not geographically close to the exchanges.

BAML does not believe that co-location necessarily gives short-term investors or proprietary firms an unfair advantage over long-term investors. Many long term investors benefit significantly from co-location services that are used by their brokers or service vendors. For example, BAML routes its retail client order flow to market centers through the same low latency, co-located networks that our institutional clients rely upon for their order flow.

We agree, however, that terms for access to co-location services should not be discriminatory, and that fees should be reasonably allocated. In this context, BAML believes that co-location services offered by exchanges and third party data centers should not be discriminatory in terms of access, service, performance, or with respect to pricing, which should be transparent. Datacenters should normalize speeds within the co-located datacenter to reduce any perceived advantage for proximity to the matching engine within the datacenter. We do not believe that market participants who obtain co-location services should be subject to any affirmative or negative obligations, rather the focus should be on ensuring fair access at the market level.

With respect to the consolidated tape, BAML believes the lack of investment by the SIP/UTP members has allowed the consolidated tape speeds to lag considerably to other data products now available to the brokerage community. We would recommend that the SEC encourage, if not require the CTA and UTP plans to commit sufficient resources to bring the CTA to the highest competitive levels so that it may remain a relevant data source for the important business and regulatory functions it supports. To do this, the consolidated tape must serve as a viable and alternative to direct feeds, as not all participants or investors may have access to the most accurate data given the high costs of direct feeds.

III. Undisplayed liquidity

Do dark pools and OTC market makers offer substantial advantages in order execution quality to long-term investors? If so, do these advantages justify the diversion of a large percentage of investor over flow away from the displayed markets that play a more prominent role in providing public price discovery?

BAML appreciates the importance of maintaining an appropriate balance between displayed markets and so-called “dark” venues or other sources of undisplayed liquidity. We have not yet seen significant evidence, however, that such undisplayed liquidity, in all its forms, has reached levels much beyond historic norms\(^4\). Nor have we seen it reach the point where price

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\(^4\) In fact, based on NYSE TAQ data, for example, quoted size at the inside actually increased 132% in S&P 500 stocks and 134% in Russell 2000 stocks from January 2009 to December 2009.
discovery is negatively impacted, or where a causal link to other potentially harmful effects, such as price volatility, can be established. BAML believes this to be true even if the ratio of displayed to undisplayed liquidity statistics shifted somewhat beyond the 75%/25% level referenced in the Concept Release. We agree that the growth in undisplayed liquidity in various dark venues or upstairs trading desks is really a migration away from other traditional, more manually intensive sources of undisplayed liquidity such as the trading floor towards the more highly automated systems available today.

Importantly, we note the value and advantages of such non-displayed sources of liquidity as an important component of the overall market structure. For example, dark pools can offer the ability to cross larger institutional orders at prices better than the NBBO. Similarly, marketable orders sent to OTC market makers can receive price improvement as well as size improvement with capital commitment, not unlike that seen for institutional customers. Even if market share were to further migrate to dark venues, most retail orders must still be publicly displayed in the public quote stream to comply with order handling rules. This results in a robust source of displayed liquidity with relatively tight spreads, and contributes to price discovery upon which other activity (including OTC market makers and mid-point crossing networks) may be based. When looking at historical Rule 605 statistics, the performance of “held” orders have improved significantly from when Rule 605 was first adopted. In addition, OTC market makers have provided a low cost alternative for retail execution, insofar as they typically do not charge fees or pass back access fees to customers when executing retail orders. Rules 605 statistics have been an important informational resource for brokers who do not internalize their order flow as they identify and monitor alternative liquidity providers consistent with their duty of best execution.

Moreover, it is not clear that the existence of dark pools results in a substantial diversion of flow that would otherwise go to a displayed market. An institutional trader can use a dark pool to search for the contra side of an order that would have otherwise remained on their blotter. Finally, we would suggest that even dark pools contribute to price discovery insofar as they are subject to the very same instantaneous trade reporting and public tape dissemination requirements that other venues and sources of “lit” liquidity are subject.

Does the fact that Dark Pools price institutional investors off of the NBBO have the potential to lead to gaming, where reference prices for large executions are established by small quoted size that can be as little as 100 shares?

BAML believes that the development and deployment of intelligent anti-gaming tools, as well as the sophisticated post-trade analyses performed by many large, institutional participants help to mitigate against the potential for large orders to be inappropriately priced.

Do exchange and ECN order types that provide undisplayed orders detract from public price discovery? Does the market need a Trade-At or Depth of Book Protection rule?

BAML does not believe the perceived benefits of either a “trade-at” rule or depth of book protection would be worthwhile. The equity markets have always operated with various sources of liquidity away from “lit” markets (e.g., internalization, dark liquidity, floor brokers holding orders in hand), and the trade through rule has done much to ensure that those who display superior prices obtain an execution before those at inferior prices, at least insofar as their orders were at the top of the displayed book. Going beyond that approach will introduce elements of a “central limit order book” or “CLOB” that has been periodically assessed and dismissed over the years as potentially...
anti-competitive. It is not in the best interests of every customer to be forced to trade in lit markets or be forced to route orders to those markets that may be quoting, especially larger institutional orders that represent the long-term investing community. The competition for liquidity and execution between all market centers and brokers leads to superior executions for all parties.

Should the fair access threshold for dark pools be lowered from 5%? If so can broker-dealer sponsored dark pools apply objective fair access standards reasonably to prevent predatory trading, but without using such standards as a pretext to discriminate based on the competitive self-interest of the sponsoring broker?

BAML would support lowering the fair access threshold below 5% to possibly 1%. We also feel that the threshold should not be applied on a stock-by-stock basis but rather the entire pool, because ATSs can avoid triggering the fair access requirement by ceasing all trading in a particular name as its volume nears the fair access threshold. We also believe that once a threshold is set by the SEC, fair access should be enforced so that meaningful pools of liquidity are not walled off from market participants (through exemptions or otherwise). Highly liquid ATSs that deny access to sell side firms often end up disadvantaging retail investors because: (i) full-service, integrated sell-side firms handle retail order flow; and (ii) retail investors are too small to become direct members/subscribers of the liquidity pools.

We thank you for the opportunity to provide these comments. If you have any questions, please feel free to contact Michael J. Lynch, Managing Director, at 646.855.3627 or Oliver Sung, Vice President, at 646.855.0216.

Respectfully submitted,

/s/ Andrew S. Margolin
Associate General Counsel

cc: Mary L. Schapiro, Chairman
    Luis A. Aguilar, Commissioner
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