

April 26, 2010

Subject: Front running order flow by using undisplayed market centers

Hi Michael,

I was trading a very thin, illiquid stock on Friday. I was long 300 shares, and had great difficulty being executed on the offer. I documented the sequence of events, as my order was stepped in front of numerous times (attached document). This trade is very typical of what happens every day, when trading illiquid listed stocks.

Knight brokerage recently posted their comments supporting broker-dealer sub-penny price improvement, showing they provided \$63 million in price improvement last year (<http://www.sec.gov/comments/s7-02-10/s70210-156.pdf> , page 4). This would be the savings to retail investors, when they internalize order flow. However, they fail to calculate the cost to retail investors, from being forced to pay the spread (as their displayed limit orders go unexecuted due to order flow being executed off the exchange).

In this instance, the bid was 5 cents below. So despite the broker-dealer internalizing in front of my displayed order, and saving their customer \$.0001, by continually internalizing in front of my order they are in essence forcing me to hit the bid \$.05 cents below. The only reason I was filled in this instance, is that the stock proceeded higher. If we take the minimum displayed MPV of \$.01 and multiply it on the 26.3 billion shares that Knight improved on last year, it equals \$263 million in cost to retail investors from having their limit orders not executed (assuming their displayed offer had to hit the bid below, and the displayed spread was the MPV of \$.01). In many instances the spread may have been larger than \$.01, as in the example I have cited, increasing this cost to investors.

Please review, and call me if you'd like to discuss further.

Thank you,

Dennis Dick, CFA  
Bright Trading LLC

## Front Running Order Flow by Using Undisplayed Trading Centers.

By Dennis Dick, CFA

Bright Trading LLC

My firm, Bright Trading LLC, recently provided comments to the SEC concerning a predatory trading practice that is compromising the NBBO. It is the practice of using undisplayed trading centers to step in front of displayed orders by an infinitesimally small amount. Today I was trading a very thin, illiquid stock where these predatory trading practices run rampant. I decided to document the sequence of events.

April 23, 2010     Ticker: RBS.PRE

### Time & Sales

<u>Time</u>	<u>Last</u>	<u>Share (100 lots)</u>	<u>Exchange</u>
10:19:35	14.04	1	FINRA TRF
10:19:48	14.04	1	FINRA TRF
10:20:00	14.0399	1	FINRA TRF
10:20:14	14.0399	1	FINRA TRF
10:20:28	14.0399	1	FINRA TRF
10:20:43	14.0299	1	FINRA TRF
10:20:58	14.05	1	FINRA TRF
10:21:15	14.0399	1	FINRA TRF
10:21:31	14.0399	1	FINRA TRF
10:21:49	14.0299	1	FINRA TRF
10:22:06	14.0199	1	FINRA TRF
10:22:22	14.05	1	FINRA TRF
10:22:41	14.05	1	FINRA TRF
10:23:00	14.0499	1	FINRA TRF
10:23:18	14.05	1	FINRA TRF
10:23:37	14.05	1	FINRA TRF
10:23:57	14.05	1	FINRA TRF
10:24:15	14.05	1	FINRA TRF
10:24:36	14.05	1	FINRA TRF
10:24:56	14.0299	1	FINRA TRF
10:25:16	14.0299	1	FINRA TRF
10:25:34	14.03	1	NYSE
10:25:34	14.04	1	NYSE
10:25:37	14.0399	1	FINRA TRF
10:25:58	14.0299	1	FINRA TRF
10:26:20	14.0299	1	FINRA TRF
10:26:40	14.0199	1	FINRA TRF
10:27:02	14.0199	1	FINRA TRF
10:27:24	14.0299	1	FINRA TRF
10:27:44	14.0299	1	FINRA TRF
10:29:58	13.99	10	FINRA TRF

## Sequence of Events

Time	Event
10:19:34	I place an order to sell my 300 shares of RBS.PRE at \$14.05
10:19:35	An algorithmic trader steps in front of my order at 14.04 (offering on NYSE exchange).
10:19:35	The stock trades at 14.04. The displayed 14.04 offer is not filled as the quote remains the same, despite the stock trading at that price. The trade was reported on FINRA TRF (FINRA Trade Reporting Facility). This means it was traded off the exchange.
10:19:48	Stock trades again at 14.04, reported on FINRA TRF, displayed offer is again not filled.
10:20:00	Stock trades at 14.0399, in front of displayed offer of 14.04.
10:20:14	Stock trades again at 14.0399, in front of displayed offer of 14.04.
10:20:18	Stock trades for a third time at 14.0399. Displayed seller is again not filled.
10:20:38	Frustrated, I move my ask price from 14.05 to 14.03. I am now the best offer.
10:20:43	Stock trades at 14.0299 in front of my 14.03 offer.
10:20:50	Frustrated, I cancel my order. The best displayed offer is now 14.05.
10:20:58	Stock trades at 14.05, but the displayed offer is again not filled. Trade is reported on FINRA TRF (off exchange). The displayed offer moves down to 14.04.
10:21:15	Stock trades at 14.0399 in front of displayed 14.04 offer.
10:21:31	Stock trades again at 14.0399 in front of displayed 14.04 offer.
10:21:41	I decide to try and offer my 300 shares again at 14.03.
10:21:49	Stock trades at 14.0299 in front of my displayed 14.03 offer.
10:21:55	Frustrated I move my offer down to 14.02.
10:22:06	Trade goes off in front of me again at 14.0199.

10:22:15 I move my offer back to 14.06. Another trader offers in front of me at 14.05.

10:22:22 - 14.05 trades 7 times, and 14.0499 trades once, but displayed offer is not  
10:24:36 filled on any of these orders.

10:24:44 I move my offer down to 14.04. Other trader immediately steps in front of me and offers stock at 14.03.

10:24:56 and  
10:25:16 14.0299 prints twice, displayed offer not filled again.

10:25:34 Displayed offer 14.03 gets filled, and I get filled on 100 shares at 14.04. Hallelujah!!

10:25:37 14.0399 trades in front of my remaining 200 shares offered at 14.04. Another trader places sell order at 14.03.

10:25:58 14.0299 trades in front of displayed 14.03 offer.

10:26:20 14.0299 trades in front of displayed 14.03 offer again.

10:26:39 I move my offer from 14.04 to 14.02.

10:26:40 14.0199 trades in front of my displayed 14.02 offer.

10:27:02 14.0199 trades in front of my displayed 14.02 offer again.

10:27:10 I move my offer back to 14.03.

10:27:24 14.0299 trades in front of my displayed 14.03 offer.

10:27:44 14.0299 trades in front of my displayed 14.03 offer again.

10:27:50 I give up and move onto another trade. Later I am filled at 14.03, and the stock proceeds to go higher (only reason I am filled).

Who is this market participant stepping in front of my displayed offer? Who is this market participant intercepting the buy orders that are trying to take my displayed offer? Who is this market participant forcing me to pay the spread and hit the bid below? According to the implied exemption given under SEC rule 612, the only market participants capable of trading in sub-pennies are broker-dealers, to offer price improvement. Is this \$0.0001 price improvement justification for compromising the displayed quote?