April 30, 2010

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

RE: Release No. 34-61358; File No. S7-02-10
Concept Release on Equity Market Structure

Dear Ms. Murphy:


Introduction

STANY commends the Commission on engaging the community of equity market professionals and investors in a discussion about and review of the current structure of the equity markets. STANY is pleased to have this opportunity to provide its members’ perspectives. We participated in numerous ad hoc meetings and discussions with members and other market participants in an effort to identify common perspectives and/or observations concerning the Concept Release and market structure in general. This letter includes the most common perspectives raised by

1 STANY is the voice of the trader in the New York metropolitan area and represents approximately 1,200 individuals who are engaged in the trading of equity securities. As such, we are uniquely qualified to discuss proposed rules and regulations affecting the purchase and sale of equity securities. STANY is the largest affiliate of the Security Traders Association (“STA”), a multinational professional association that is committed to being a leading advocate of policies and programs that foster investor trust, professional ethics and marketplace integrity and that support education of market participants, capital formation and marketplace innovation.

We believe that strong efficient markets that support capital formation require an appropriate balance between effective regulation on the one hand and innovation and competition on the other. We support innovation in the markets and believe that competition is the best driver of innovation and market improvements. We appreciate and support the existence of various centers of liquidity including registered exchanges, ECNs, ATSs, and market makers the existence of which provide choices for investors and help to maintain the primacy of the US capital markets.


3 STANY incorporates by reference comments previously submitted in response to proposed regulations. See Letter of Kimberly Unger, Executive Director, Security Traders Association of New York, Inc. to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission dated Match 29, 2010 (Risk Management Controls for Broker Dealers with Market Access), Letter of Kimberly Unger, Executive Director, Security Traders Association of New York, Inc. to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission dated February 17, 2010 (Regulation of Non-Public Trading Interest), Letter of Kimberly Unger, Executive Director, Security Traders Association of New York, Inc. to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission dated September 21, 2009 (Amendments to Reg. SHO)
participants in these discussions. No representations are made that the perspectives, observations and opinions were uniformly shared by all members.

As the Commission notes, the US equity markets have changed significantly in the last 20 years. The adoption and implementation of Regulation ATS and Regulation NMS have served to change equity trading from an exchange centric practice to one in which a variety of businesses-Exchanges, ECNs, ATSs and broker dealers compete to serve the investing public. Enhancements to technology and increased competition have served to reduce trading costs, reduce spreads, democratize the markets and produce more accessible and liquid markets than ever before. These changes have benefited investment and capital formation. To ensure that regulation and enforcement keep pace with the dramatic changes periodic review is warranted. We appreciate that the Commission is taking a deliberate and thoughtful approach to considering whether regulatory changes are needed to ensure that the US markets remain vibrant and efficient.

While assessment and review are appropriate, sweeping changes should be avoided unless the need for those changes is supported by empirical data. The vast majority of our diverse membership does not believe that there is a need for extensive regulatory change in the equity markets. In general our members favor regulation that provides investors and market participants with the information and knowledge they need to make informed decisions and offers all market participants choices as to where and how they buy and sell equity securities. As such, we suggest that any regulation which will effectively limit investor choice be thoroughly considered and supported by evidence that demonstrates that the rule change is needed and that the benefits will justify the potential costs and unanticipated consequences.

We believe that it is incumbent upon the Commission to follow basic principals of good regulation as outlined by the Committee on Capital Markets Regulation (the “Committee”) The Committee acknowledged that the cost benefit rule must be applied to all other principles of good regulation and held as a cornerstone for its work the premise that; “… a given regulation should be promulgated only when its benefits outweigh its costs. Furthermore, if different kinds of regulation can achieve the same benefit, the regulation with the least cost should be adopted.” We agree that good regulation requires an analysis of the costs and realistic benefits of such regulation. We believe that it is imperative that the Commission support any regulatory changes with empirical data. We urge the Commission to conduct a through analysis of the impacts of each regulatory change prior to implementation and introduce change slowly through pilot programs that allow the Commission and market participants to analyze the possible unanticipated consequences.

As the Commission undertakes this review we would also encourage the Commission to work with foreign regulatory bodies to ensure that regulatory reform does not damage the United States’ status as a premier world market, does not lead to international regulatory arbitrage and does not drive businesses or trading from the United States.

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4 See e.g. The Global Financial Crisis, A Plan for Regulatory Reform Recommendations to Reduce Systemic Risk and Make Markets More Transparent, Committee on Capital Markets Regulation (May 26, 2009) The Committee on Capital Markets Regulation is an independent and nonpartisan 501(c) (3) research organization dedicated to improving the regulation of U.S. capital markets. Twenty-five leaders from the investor community, business, finance, law, accounting and academia comprise the Committee’s membership. The Committee co-Chairs are Glenn Hubbard Dean of Columbia Business School, and John L. Thornton, Chairman of the Brookings Institution. The Committee’s Director is Professor Hal S. Scott, Nomura Professor and Director of the Program on International Financial Systems at Harvard Law School. The Committee’s research regarding the regulation of U.S. capital markets provides policymakers with a nonpartisan, empirical foundation for public policy.

5 Ibid Executive Summary p.4.
Market Performance and Market Structure

At the onset, it is important to note that the majority of our members share an ardent belief that the US equity markets, under the current market structure, function exceptionally well. This belief is supported by empirical data. Quantitative and qualitative analysis across the board show that investors have benefited from the growth of electronic trading and the changes in the market since the introduction of Reg. ATS in 1998 and Reg NMS in 2007. “The winners first and foremost, have been the investors who now obtain better services at lower cost from financial intermediaries than previously.” This is true for institutional as well as retail investors.

As astutely described by the Commission in the Concept Release, the US currently has a mature and interconnected market structure. Developments in the markets have reduced trading costs to all time lows, narrowed spreads, expanded the range of trading tools available to investors and revolutionized fair access for retail investors, institutional traders, and professional traders alike.

It is important to acknowledge however, that the last two years have been characterized by economic factors that have contributed to a feeling of unease with the economy. Unfortunately, the downturns in the residential real estate market, the loss of jobs, and crisis in the debt markets have translated into feelings of unease with the equity markets. Regardless of perceptions, the US equity markets have proven to be extremely resilient through one of the most challenging times in economic history. During the 2008 financial crisis the US equity markets, in contrast to other markets (such as the debt markets) operated without interruption and allowed investors to locate and access liquidity at all times. While it is commendable that the Commission is engaging in a focused review of the equities markets, all indications are that this review and ultimately reform should be focused on the debt market and the markets for OTC derivatives that do not clear on exchanges. These instruments, not equities or the structure of the equities markets, clearly caused a rend in the financial fabric of United States and the world.

We do not believe that there is a measurable crisis of confidence in the US equity market structure. Unfortunately, the media and others have politicized and popularized the notion that “Wall Street” is to blame for all financial ills in the economy without any distinction between equities and other instruments. This Wall Street vs. Main Street rhetoric gives the impression of a lack of confidence, which we do not think is born out by evidence. Given the increased volumes in the markets, it appears that contrary to perception, confidence in the equity markets has not materially diminished. Notwithstanding, investor confidence is too nebulous a concept and should not dictate regulation. Imposing regulation in response to public perceptions and vague notions of investor confidence will not produce the best regulation. On the contrary, adding or changing regulation without a basis firmly rooted in empirical evidence could prove damaging to the markets and to the elusive concept of investor confidence. Lasting confidence can only be achieved when well reasoned rules are implemented. Unintended negative consequences will not serve to make investors more confident in the US markets or in the Commission.

We understand that the Commission needs to examine the marketplace in response to public outrage about unfairness. We believe that a certain measure of this outrage is caused by confusion about the markets. This confusion may be understandable in light of the dramatic changes in the equities markets in the last decade. For example, the Commission has received a number of letters concerning a perceived lack of fairness in the markets caused by “[t]he exemption granted to broker dealers to engage in sub-penny trading.” It is believed that this disparate treatment results in a two-

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tiered market favoring broker-dealers over “trading professionals.” Price improvement, mid-point matching, and access fees can result in executions that occur in sub-penny increments; however it is a misperception that in today’s markets orders can be entered by broker dealers in sub-pennies. Rule 612 of Reg NMS proscribes minimum pricing increments and provides that “(a) No national securities exchange, national securities association, alternative trading system, vendor, or broker or dealer shall display, rank, or accept from any person a bid or offer, an order, or an indication of interest in any NMS stock priced in an increment smaller than $0.01 if that bid or offer, order, or indication of interest is priced equal to or greater than $1.00 per share.” We are not aware of any exceptions to this rule. This is but one example of how a misunderstanding can lead to misperceptions about fairness. This does not mean that the criticism of the markets should be dismissed out of hand; rather it suggests that a careful assessment of the functioning of the capital markets is needed and that the results of that assessment should be communicated to the public. For example, we are hopeful that the Commission can enhance understanding of the markets by providing additional transparency through amendments to Rule 605 and 606 (discussed elsewhere in this letter.)

Of course, as vibrant as the equity markets are, the current regulatory and market structure are not perfect. The dynamic evolution of the US markets necessitates periodic rational, detailed and well-evidenced review. Therefore we are supportive of the Commission’s efforts to optimize regulation and commend the undertaking of this review and the thoroughness of the Concept Release. We would however, echo the sentiments of Senator Mike Crapo, who “would encourage you [the Commission] to base decisions on empirical evidence and well accepted theoretical models about how these changes are in the best interests of individual investors.”

Given that the interest of investors and buy-side or institutional traders, who trade on their behalf, is of paramount importance to the Commission, it is interesting to note that there is little buy-side support for increased regulation. Rather institutional investors seem to have a greater concern that the Commission and Congress may take inappropriate action that would have a negative impact on their ability to trade efficiently for their clients. They fear that liquidity will be impeded or pulled from the market and that the ability to trade anonymously and in size will be hampered. For the most part the institutional investor believes that he or she is in the best position to determine how and when to execute transactions on behalf of his or her client and wants to see choice and competition rather than legislative or regulatory fiat drive the markets.

As the Commission well knows, the US market structure is extremely complex. For better or worse, and we think better, a symbiotic relationship exists among exchanges, ATSSs, institutional investors, retail investors and professional traders employing high frequency trading strategies. Each of these participants adds to the overall functioning of the markets. As the Commission notes “…trading centers offer a wide range of services that are designed to attract different types of market participants with varying trading needs.” We think this is a good thing. We believe that a system wherein competition drives innovation and investors are free to choose how and through whom they participate coupled with a solid foundation of surveillance and regulatory oversight is best for the US economy. As the Commission stated in its reproposal of Reg NMS, Reg. NMS is “designed to strengthen and enhance the efficiency of linkages among the various competing markets, but without mandating any particular type of trading model” and that “[i]nvestor choice and competition will determine the relative success or failure of the various competing markets.” We could not agree more.

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7 Letter from Senator Mike Crapo to Chairman, Mary Schapiro dated February 24, 2010, p. 1
Participants have and will make suggestions to the Commission based upon their particular position in this ecosphere. It is best to acknowledge that none of the various players—Exchanges, ECNs and ATSs, broker-dealers, investors, issuers and traders—participates in the equity markets for altruistic reasons. Were there not the potential for profit, there would be no investment and no one to facilitate it. All parties from individual investors to professional traders to exchanges to issuers participate in the equity market for economic gain. The potential for economic gain is what drives investment and capital commitment. If those who participate in the secondary markets do not profit, the participants will find something more rewarding to do with their resources and the market will suffer. Capital will not be raised unless the people providing the capital and assuming the risk (whether for a second or for a year) have an opportunity for financial gain.

Because competition drives the markets, the Commission should be wary of the motives of some of those most vocal and dissatisfied with the markets. We should not ignore the fact that liquidity providers, whether they are market makers or high frequency traders, are willing to commit capital and provide liquidity because they can make money doing so. Likewise, although institutional investors are guided by the best interests of their clients, no fund or fund manager engages in a transaction without the potential to protect or increase performance of their products. The Commission should be wary of those who call for change simply because someone other than, or in addition to, themselves is profiting. If the Commission were to regulate, or Congress legislate, against profit, who then is going to provide liquidity?

Recognizing that rule making and the changes attendant thereto will likely economically benefit some and disadvantage others, we do not believe that it is, or should be, the Commission’s mandate to implement rules based upon which person or group will be helped or harmed. It should not be the goal of legislation or rulemaking to protect one business model over another and the fact that one or more business models may suffer should not be the driving force behind change or lack thereof. Rather the best interest of the market as a whole—meaning how well it serves to raise capital and attract participants—should dictate whether regulation is appropriate and necessary. Our members believe that it is in the best interests of the markets and investors overall for competition to determine which model or models ultimately succeed and which do not.

**Long Term v. Short Term**

As the Commission notes it is not possible to easily define what it means by a “short” term or “long” term as the terms relate to traders/investors. Many market participants fall along a continuum either because they engage in both long and short term trading or because their trading habits cannot be easily classified. Given that concepts such as “short” and “long” are relative and that there is no bright line test to separate between long term investors and short term traders, we do not believe that it would be appropriate to fashion different rules based upon a holding period.

Even if it were not so difficult to distinguish between long and short term investors and traders, we question whether such a distinction would be appropriate. We do not believe that the interests of short and long term market participants are as divergent as the Commission seems to suggest. Reduced transaction costs have created an opportunity for all equity investors to profit from relatively short-term trading strategies, as compared to prior periods. They also promote capital raising activities because people are more willing to invest when the risk of loss from exiting an investment is reduced. In general we believe that even so-called “long term investors” trade more frequently than was the case a decade or so ago.
In this Concept Release the Commission acknowledges a preference for the interests of long term investors over those of short term traders. We do not doubt that that preference is intended by the Commission to focus its rulemaking in such a way as to promote capital formation and encourage investment in the US capital markets. As participants in and beneficiaries of capital formation, we recognize these aims as valid and to be encouraged. Nevertheless, it is imperative that both long and short term participants be recognized as essential to a well functioning market system. We agree with comments made by The Shadow Financial Regulatory Committee, who note in a their comment letter to the SEC that

…focusing on long-term investors and trying to protect the direct retail trader reflects a naïve view of the interests of investors and traders. Some investors, particularly small retail investors, can trade with virtually no market impact. Other investors, primarily institutional investors, are rightly concerned about the impact their orders might have on market prices. How investors react to the rules of the market that the SEC sets will depend in part upon the information upon which they are trading, the size of their orders, and the potential market impact, and investors respond differently to SEC rules depending upon their diverse needs.

Markets must be liquid so that those who chose to invest will be comfortable knowing that when and if they chose to divest they will be able to do so easily and inexpensively. Without a certain level of comfort that there will be a ready and willing buyer, investors will be reticent to provide capital through equity investment. Therefore, we believe that the best equities markets are those that permit and encourage various trading strategies. The secondary markets would not be as robust as they are were it not for many participants willing to enter the markets, assume risk and provide services to those interested in investing. For that, both long and short term investors are needed.

It is also inappropriate to assume that all short term traders are professionals or employees of proprietary trading firms. As can be seen from the comments received by the Commission in response to this Concept Release, there are a fair number of individuals who view themselves as “traders” who are trading their own accounts and are not Wall Street professionals or registered investment professionals. Likewise, short term strategies and even “high frequency trades” are employed by firms that are trading on behalf of retail and institutional clients. While an individual may be invested in a mutual for the “long term” the fund itself might employ “short term” trading strategies as a way to hedge risk or increase profitability.

High Frequency Trading is similarly impossible to Define and should not be labeled as “good” or “bad”

Although the Commission has suggested elements that could be used to define a “high frequency trader”, a clear definition is elusive. Nearly all trading activity in the U.S. equity markets is done through high speed computers and fiber optic connections. Many retail orders come from internet terminals with broadband access to retail brokers’ data centers that package those orders on behalf of the retail customers and submit them through servers co-located at each exchange. The vast majority of all inbound subscriber connections exhibit many, if not all, of the attributes that have been labeled “high frequency trading.” Today's markets are simply more connected, more efficient,
and handle more transaction volume that most people understand. Within the industry there is concern “that there has been a lot of obfuscation in the popular media about the nature and significance of this type of order flow. … Such inaccuracies or misinformation is damaging to the markets, that everything from flash orders to naked access is being lumped in with the ability to execute automated quantitative strategies in micro-second speeds and the ability to hide in the dark.”\textsuperscript{10} We would caution the Commission against using the term “high frequency trading” as it has mistakenly been used pejoratively to describe activity that is not so much harmful as it is misunderstood.

Attempts to regulate basic elements that underpin the entire market infrastructure are likely to have long term, profoundly harmful ramifications. The automation of trading in the U.S. equity markets has increased liquidity, decreased spreads, lowered transaction costs, and reduced the time necessary to trade. These benefits inure to all participants, particularly retail and institutional investors who are paying historically low trading costs to interact with the market at higher speeds and with greater certainty than ever before.

Technology and modernizing rule changes – particularly decimalization and the Order Handling Rules have diminished spreads, making it less profitable for professional trading firms to engage in traditional specialist or market maker functions. As the profitability of risking capital as a market maker declined, businesses have sought alternative ways in which to profit. High frequency trading firms are an outgrowth of the regulatory and systemic changes that make market making less profitable. Although traditional market makers continue to participate in the markets, high frequency trading firms have filled some of the void left by the declining numbers of traditional specialists and market makers. Opening up of the markets after the passage of Reg. NMS and the competition permitted among the various market participants, has lead to narrower spreads, lower trading costs, increased liquidity and overall efficient markets. It is important that the Commission appreciate that the liquidity provided by high frequency strategies has added to the robustness of the markets. Any regulation, that would place unnecessary restrictions on these strategies, needs to be extremely carefully considered.

In contrast to specialists and market makers, these firms do not have “affirmative obligations” to buy and sell even when a market is moving against them in order to facilitate orderly markets. Nor do they have “negative obligations” to refrain from stepping in front of customer orders or otherwise taking advantage of their knowledge of customer order flow. While, we have heard some expressions of concerns that given the lack of obligations, high frequency traders can “disappear” when liquidity is most needed. Although we do not believe that there is evidence to support this concern at this time, it is something of which the Commission should be mindful. At present we do not think that the imposition of affirmative or negative obligations on “high frequency traders” is necessary. We would however, like to see proper recognition of the vital role that market makers and DMMs play in the liquidity picture. As STANY has expressed in the past, we believe that bona fide market makers and bona fide option market makers should be granted exemptions to certain rules because of the obligations they accept on behalf of the markets.\textsuperscript{11}

Despite the fact that much legitimate trading could fall under the rubric of “high frequency trading,” it is appropriate for the Commission to monitor trading activity to ensure against fraud and


\textsuperscript{11} See Letter of Kimberly Unger, Executive Director, Security Traders Association of New York, Inc. to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission dated September 21, 2009 (Amendments to Reg. SHO)
manipulation. In this regard we note that some “high frequency trading” is being done by people or firms that are unregulated and have been given access to exchanges and ATSSs as if they were regulated. Given that estimates attribute as much as 61% of the daily US equity share volume and 70% of daily total trades to some form of HFT, it may be in the best interests of the markets for the SEC to assume tighter controls over those heretofore unregulated individuals and/or entities. In this regard, STANY supports those provisions of the Commission’s proposal on Market Access as they relate to “naked access.” Likewise, at least in theory, the Large Trader Reporting System Rule proposed by the Commission could provide a useful tool for regulators seeking to identify and monitor trading activity of unregulated entities and individuals. We have not yet analyzed the proposal and are therefore unable to fully endorse it. One concern might be that the rule may be overly broad and encompass individuals or entities that need anonymity such as institutional investors seeking to execute size orders with minimal impact. However, if as reported, the identity of the “large trader” would only be available to the Commission (and other appropriate regulators) and used exclusively “to help the Commission reconstruct market activity, analyze trading data, and investigate potentially manipulative, abusive or otherwise-illegal trading activity”, we anticipate supporting the rule (or a modified version.)

Tools for Measuring Market Performance

The Commission has sought comment on whether changes are needed to Rules 605 and 606 of Reg. NMS which relate to the measurement of market quality and disclosure of order routing practices respectively. Although the rules have proved useful in that they have provided comparable statistics across market centers, we believe that it is appropriate for the Commission to consider amendments to these rules to provide large and small investors with additional useful data.

We encourage the Commission to review and amend Rule 605 and 606 to render them more effective for those who make execution and routing decisions. Since the adoption of Rules 605 and 606 in 2000, technological advances have made some of the measurements in the rule less meaningful. An update of Rules 605 and 606 is needed in order for reports to reflect the order execution and routing practices employed in today’s markets. For example, execution time categories in the reports should be adjusted to reflect the significant decrease in execution times since adoption of the rules. We suggest that a standardized set of metrics which might include revised speed of execution data, linkages and access to markets and other measurable data the disclosure of which will provide investors and traders with adequate information upon which to make execution and routing decisions. Enhanced metrics will also offer a clearer picture of the fairness of the current market structure and provide the Commission with additional empirical data upon which to make future decisions about the direction of regulation.

Sub-penny quoting

13 STANY Letter to SEC dated March 29, 2010. While STANY opposes naked access, we believe that the Commission’s proposal on direct access should be modified to recognize different forms of market access, with more stringent requirements placed on direct access by unregistered market participants as compared with registered broker dealers who use other broker dealers MPIDs for access.
14 Securities and Exchange Act Release No. 34-61908; File No. S7-10-10 Large Trader Reporting System
15 See, Speech by SEC Chairman: Opening Statement at the SEC Open Meeting — Large Trader Reporting System, Chairman Mary L. Shapiro (April 14, 2010)
16 STANY plans to submit comments to the Large Traders Reporting System release in a separate letter to the Commission.
STANY has in the past opposed, and continues to oppose quoting in sub-pennies. While certain market participants, including some of our members, have recently expressed an interest in sub-penny quotes, we do not believe that the equities market will benefit from quoting in sub-pennies for stocks priced above one dollar. Penny quoting was implemented in 2001 partly in an effort to make prices more understandable and accessible for investors. Sub-penny quoting will be a step backward.

Allowing sub-penny quotes would at best provide negligible benefits to investors, while the costs and negative consequences could be substantial. The exponential expansion of each of the now 100 ticks per dollar to 1,000 ticks per dollar will require addition bandwidth, take up significant computer screen space and require all market participants to retool every aspect of their trading software. As the depth of the market at each price point declines it will take multiple transactions to complete an order thereby increasing transaction costs. We would also expect to see the value of the NBBO as a price discovery tool decrease.

Sub-penny quoting will also exacerbate perceived problems with “trading ahead.” Sub-penny quoting will serve as an economic incentive to “step ahead” of published limit orders. The cost of stepping ahead will be reduced from a dollar (the minimum increment for a quote currently being 100 shares at .01 per share) to ten cents (100 shares at .001) or even one cent (100 shares at .0001). Sub-penny quoting will only make it cheaper and easier for to “game the market” and we would expect to see both an increase in gaming and an increase in the public perception that gaming exists even when it does not.

Were the Commission to consider permitting sub-penny pricing, we would hope that the Commission would limit the exception to stocks trading under a certain dollar amount where penny spreads represent a higher percentage of the share price. In this regard there has been some discussion of expanding sub-penny quoting beyond the under $1 threshold to stocks priced between $1 and $5. The SEC could allow these exceptions under Reg NMS Rule 612 (c) which would permit the Commission, by order, to exempt from minimum pricing requirements “any person, security, quotation, or order, or any class or classes of persons, securities, quotations, or orders, if the Commission determines that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.”

Access fee caps would also have to be adjusted to make sure that the caps are below the minimum increments. Alternatively, if the Commission permits pricing then any access fees could and should be included within the applicable quotation.

Given that the Commission may effect changes to the minimum increments on a security by security basis, if the Commission considers altering pricing increments for some securities to less than one penny, we believe that the Commission should also consider whether certain higher priced liquid securities would benefit from minimum increments of greater than one penny- for example minimum increments of .05.

Trading Strategies should not be categorized as “good” or “bad”

Given the difficulty of defining a trader or investor as long or short term, the Commission has asked that participants consider various strategies employed by high frequency traders and provide feedback on whether a particular strategy is “good” or “bad”, “harmful” or “beneficial” to the markets. We hesitate to define any legitimate and legal strategy as inherently good/beneficial or inherently bad/harmful. Just like all types of traders, we believe the best system is one in which there is choice and room for many types of strategies.

None of the trading strategies outlined by the Commission in the Concept Release are new. These or substantially similar strategies have been employed since the beginning of trading and have, in various forms, been utilized by a range of market participants. Trading strategies are as diverse as are the individual personalities who trade and invest in the markets and should not be categorized and weighed against some non-quantifiable moral yard stick. Absent clear fraud or manipulation we do not believe that it is either possible or helpful for the Commission to label some strategies as good and other strategies as bad.

Rather than placing arbitrary limits on choices available to investors or traders, the Commission should focus on ensuring that market participants do not employ these otherwise neutral trading methods for manipulation. The markets would be better served by the Commission’s use of its antifraud authority to monitor and address specific instances of fraud and manipulation. Transactions that are employed to manipulate the markets are violations of existing regulations and should be punished. The way to protect markets from those who wish to manipulate stock prices is to have a robust and efficient surveillance system. In this regard we respectfully suggest that the Commission focus its attention on surveillance and enforcement of existing regulations.

Displayed v. Undisplayed Liquidity

Undisplayed liquidity exists in many forms and includes trading interest on some exchanges and ECNs, ATS orders, orders held and worked on buy-side firms on behalf of institutional investors and by broker-dealers as part of their firm’s capital commitments. Undisplayed liquidity, in various forms, has served to facilitate size discovery for decades.

Although undisplayed liquidity has existed in many forms for as long as people have been trading equities, technological changes, the advent of algorithmic trading and the evolution of micro-second trading speeds have given rise to questions about so called “dark” pools.

Contrary to the public perception, rather than serving as venues for illicit, mysterious or nefarious trading activity, “dark” pools offer market participants alternative sources of liquidity and choices of execution venues. Alternative-off exchange-liquidity is accessed by broker-dealers on behalf of retail customers, institutions on behalf of their mutual fund investors as well as by traders with proprietary interests. As the Commission has acknowledged there is a need for targeted size discovery mechanisms that enable investors to trade efficiently in size orders and undisplayed liquidity is often used by those wishing to avoid adverse market impact when executing their trades.

Although the Commission has consistently sought to promote the public display of orders, it has, with the exercise of sound judgment, never sought to prohibit trading venues from offering “dark” liquidity services to investors. Although it may appear that the present market structure is one of high fragmentation, communication and computing technologies now allow a tremendous amount of connectivity reducing true fragmentation to a thing of the past. These electronic innovations have greatly reduced the costs of searching for and accessing liquidity at exchanges and other trading venues.

We do not believe that the existence of undisplayed liquidity has materially harmed price discovery. Despite the existence of ATSs and “dark pools” displayed markets continue to prosper. The best measure of price discovery is quoted spreads. If there is not enough incentive to post limit orders, the result would be a widening of quoted spreads because intermediaries would charge more to post limit orders. But all the data shows that quoted spreads are narrowing. The narrowing of quoted spreads directly contradicts the assertion that dark pools or internalization are negatively affecting
price discovery. The aggregate market share of lit markets as a percentage of overall market volume has remained relatively constant over time.

Undisplayed liquidity provides broker-dealers and dark pools with a reason to accept orders, because by internalizing they can make a profit. If required to display liquidity, they will have to find some other way in which to receive compensation—such as charging commissions or fees for market access. Moreover, the greater broker-dealer internalization of retail orders, as compared to the institutional preference for dark pools, reflects the greater service needs for retail order flow.

If the Commission is going to propose restrictions on competition and investor choice, it should only do so if the data clearly supports that decision.

Trade-at rule

The Commission has questioned whether if it is believed that the quality of price discovery has been impaired by undisplayed liquidity; a "trade at" rule would be advantageous. As stated above, we do not believe that undisplayed liquidity has impaired price discovery. Likewise, we do not believe that a trade-at rule would provide meaningful benefits to the market and are concerned about the negative impacts on competition that could result for such a rule.

The trade-at rule would prohibit any trading center from executing a trade at the NBBO unless the trading center was displaying that price at the time it received the incoming contra-side order. The trade-at rule would require a trading center not displaying the NBBO at the time it received an incoming marketable order either to execute the order with significant price improvement (e.g., the minimum allowable quoting increment), or route inter-market sweep orders ("ISOs") to the full displayed size of NBBO quotations and then execute the balance of the order at the NBBO price. The trade-at rule is similar to a central limit order book ("CLOB") that has been considered and rejected by the Commission in the past.

As with the rejected CLOB, the trade-at rule will limit the competitive advantages that currently exist with dispersed but connected order flow. By giving preference to investors who display orders over investors who decide it is not in their best interests to do so, the trade-at rule will hamstring institutional investors and give them significantly less options in seeking best execution.

We have repeatedly heard that institutions representing long term investors through mutual funds feel it is imperative that the choice of interacting in the public markets be left with the investment professional making investment decisions. As the Commission notes, there is a, “very substantial availability of undisplayed liquidity for executing retail orders at non-exchange venues, particularly OTC market makers and liquidity pools sponsored by broker-dealers.”

A trade-at rule will also increase costs on both retail and institutional transactions. Uses of lower cost alternative venues may be forced to execute on exchanges and pay access fees. It should also be noted that when access fees are taken into account, the NBBO quote is not necessarily the best available quote. A trade-at rule will also reduce opportunities for price improvement. Transactions which are now offered sub-penny price improvements when executing against undisplayed liquidity would trade at the NBBO plus access fees as opposed to the NBBO with price improvement price improvement.

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18 Concept Release at 3613.
Any serious consideration of a trade-at rule required both empirical data showing that price discovery has been harmed by undisplayed liquidity and a thorough review and analysis of the potential impact the rule would have on various liquidity providers and market participants. The Commission spent a tremendous amount of time and effort on determining whether to implement a trade-through rule. Similar study and analysis should be undertaken before any decision to implement a trade-at rule.

Co-location, proximity location and individual data feeds

Questions have been raised about whether co-location provides unfair advantages to certain market participants and/or classes of investors and whether the Commission should ban or somehow restrict co-location. There seems to be misunderstandings about co-location and proximity location and how these services are provided. Contrary to these apparent misperceptions, co-location is not inherently bad either for long term investors or for the markets and we do not advocate banning or proscribing co-location.

We do not believe that co-location confers unfair advantages on the firms that choose to co-locate. Market participants have always had the opportunity to avail themselves of different level of services and technology in accordance with their financial and operational resources. Co-location and proximity location arrangements are available to any firm willing to devote resources to them. “Investor, broker-dealers and traders that expend resources on co-location or proximity hosting have no more of an unfair advantage than those that expend funds on superior computer systems, data feeds, top-quality fundamental research, advanced trading strategies or more qualified personnel.”

We would refer the Commission to the letter submitted in repose to this Concept Release by SAVVIS, Inc. which explains in great detail co-location and proximity location.

“To the extent that brokers or investors who invest in technology, such as faster and better computers, gain an advantage, they do not obtain an unfair benefit that others cannot obtain for themselves…. Any qualified investor or brokerage firm can obtain a lease form a proximity hosting data site and retail investors can obtain access to both faster computers and co-located computers by transacting their trades through a broker-dealer that has such access without the need to directly invest in such technology.”

It is important to recognize that co-location arrangements with registered exchanges are subject to the fair access requirements of the Rule 19(b) of the Exchange Act. Exchanges offering co-location must file proposed rule changes with the Commission and the Commission regulates fees and terms of access. As long as co-location is provided on a fair access basis so that participants who want to put their decision making systems close to exchange systems are treated in a non-discriminatory fashion with fees being both reasonable and equitably allocated among uses, we do not see co-location as conferring an unfair advantage on those who choose to co-locate. Likewise, we do not believe that co-location gives short term investors an unfair advantage over long term investors. Both short and long term investors benefit from co-location services that are used by their brokers or service providers. Retail investors generally enter the market through intermediaries who can easily avail themselves of co-location arrangements. Thus retail customers can achieve the operational advantages of co-location by choosing to send their businesses to firms that have expended the capital to gain a competitive position.
Co-location reduces message latency, and as latency is reduced, so is trading risk. As risk is reduced, so are spreads. Some firms seek co-location or proximity location services as a way to reduce telecommunications costs, which in turn reduce the overall costs of trading. With or without co-location market participants will continue to seek ways to reduce latency and thereby reduce the time and expense of order execution. Whether market participants place their servers at an exchange’s facilities, or seek the services of third party proximately hosts, or engage in a bidding war for property and office space next door to those locations, location will for the foreseeable future be an issue with firms seeking to be as closely located as possible in an effort to reduce latency as much as possible.

Unlike exchanges, proximity hosting services are not subject to the same regulatory requirements, nor do we believe that they should be regulated as “facilities of an exchange. To the extent that those providing these services are not acting as exchanges, ATSs or broker-dealers, but rather acting in the capacity of “landlord’ we do not believe that there is any basis for them to be treated as exchanges. The presence of these proximity service providers reduces the barriers to entry that would exist if all market participants needed to build their own data sites at or near market centers. We believe that competition should determine whether proximity hosts business models survive or fail.

Questions have been raised concerning the fairness of market participants using individual data feeds. We do not support restrictions on the use of market data or communications technology and view any steps to impose delays on the dissemination of information over data feeds to be a step backwards. Slowing the flow of market information would impede price discovery and reduce pricing efficiencies. The advances of the last ten years have been such that today investors have access to more and better information faster than ever before. To place halts on this data would be anti-competitive. The markets would be better served by encouraging exchanges to provide individual data feeds on fair and equitable terms to any market participant who is willing to pay for such a feed. Rather than slow down market feeds, we believe that the Commission should encourage CTA and UTP plans to commit resources to bring the consolidated tape to a level were it can viably compete with individual data feeds.

**Enforce Existing Regulations and Provide for Centralization of Surveillance**

Rapid technological and communication innovations have changed the way in which equities are traded. Investors and traders currently have multiple trading venues and services from which to choose. Competition among various trading venues and liquidity sources for order flow is generally a positive development. What seems to not have kept pace is market surveillance.

No single regulator has a complete picture of all trading activity in the equity markets. Where prior to Reg. NMS the NYSE might have enjoyed 80% of market share in exchanged listed equities, it currently has closer to 25%. When the NYSE had an 80% share of the volume in its listed equities, it was able to monitor and observe 80% of the trading in that security. The same was true with the NASD monitoring trading on NASDAQ. Each SRO is responsible for regulating and monitoring trading conducted on its market. However, trading strategies, technological advances, and market structure changes that have advanced the markets have also made it difficult for regulators to get a compete picture of transactions that may be spread across multiple venues and among multiple asset classes.

Markets would be better served by enhancements to the regulatory structure than through additional regulation that places limitations on investor choice. We believe that regulators need a structure whereby they can monitor and detect suspect activity across markets and products. We suggest that
co-ordination is needed to link order audit trail data which is currently available to regulators through FINRA’s Order Audit Trail System (“OATS”) and NYSE’s Order Trading System (“OTS”). Not only are these systems not linked, there is no standard convention for identifying market participants across markets. A uniform system of order, trade and quote information across all equity and options markets, together with a sufficiently granular audit trail would assist regulators with surveillance of the markets for potential violations of existing rules. We would also suggest that the Commission review and consider registration requirements of market participants, many of whom are currently not required to be registered by FINRA. Enhanced surveillance and enforcement should go a long way toward improving investor confidence in the markets and providing protection for investors.

**Conclusion**

STANY appreciates and supports the Commission’s continued commitment to evaluate and enhance the performance of the equity markets and modernize market structure regulations. We believe that the US markets are the best in the world because market structure has been driven by innovation and competition and provide investors with choices regarding execution venue. Despite populist perceptions, by every measurable statistic the US markets today provide a more equitable playing field for all investors than ever before. We believe that an enhanced and comprehensive inter-market surveillance and increased transparency through updates to Rule 605 and 606, together with the Commission’s exercise of its existing authority to address fraudulent and manipulative trading practices would go a long way to addressing any perceived problems with the equity market structure.

We suggest that any changes to the structure of the equity markets must be undertaken with great care to avoid or minimize unintended consequences. Changes should only occur if, after a thorough review of all empirical evidence, it is determined that the benefits of the change far out weigh the costs or potential negative consequences.

We thank the Commission for the opportunity to provide comment on this Concept Release. We look forward to sharing further comments and perspectives on equity market issues as the Commission considers additional initiatives and specific rule changes.

Respectfully submitted,

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