November 4, 2019

Via e-mail: rule-comments@sec.gov

Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
United States of America

Dear Secretary,

Re: File Number S7-18-19 (Commission Statement on Market Structure Innovation for Thinly Traded Securities)

We thank the SEC for this opportunity to offer some suggestions on promoting liquidity in thinly traded securities. Our comments are based on our collective experience trading on stock markets both in the United States and in 28 other countries Although not tested against academic research, these comments are based on observations of those rules and regulations which do seem effective in promoting price discovery and liquidity.

For the purposes of our comments, we accept the provisional definition of "thinly traded securities" as being any security with an average daily volume ("ADV") of less than 100,000 shares (although see our Comment #9 below for additional metrics to consider).

1. Consider "Order Exposure Rule" for Thinly Traded Stocks. A fundamental issue with thinly traded securities is information asymmetry: wholesalers that trade off-exchange will, through such price negotiations, obtain superior and more current information than retail investors or proprietary trading firms such as ours. This informational asymmetry imposes a significantly enhanced risk for market participants interested in thinly traded securities relative to liquid securities where continuous intraday trading and deeper levels of bid-ask quotes provide significant pricing transparency to all market participants.

   We note that Canada has long had an "Order Exposure Rule"[1] whereby all registered broker-dealers (referred to as "Participants") must immediately display on a visible market client orders to purchase or sell 50 board lots or less of a listed stock (subject to certain exceptions, such as block orders with a value of over C$100,000). This Order Exposure Rule is widely credited with giving Canada an international edge in promoting capital formation in mining,

[1] See Rule 6.3 and related Rule 6.4 of the *Universal Market Integrity Rules* of the Investment Industry Regulatory Organization of Canada, found at https://www.iiroc.ca/industry/rulebook/Documents/UMIR0603_en.pdf . Rule 6.6 (colloquially referred to by some as the "Trade At Rule") is a form of exception to this Order Exposure Rule by permitting trading of retail orders in a dark pool provided there is price improvement over the current NBBO.

natural resource and other start-up companies. We urge the SEC to consider implementing a similar version of this rule in order to boost price discovery and liquidity in U.S. thinly traded securities.

2. Concentrating Liquidity. One possibility to consider would be to limit trading of listed thinly traded securities to lit markets only and not permit their trading on dark pools (subject to exceptions for large block trades – see comments #7 and #8 below).

3. Market Data Fee Relief. It is a core principle of U.S. securities regulation that market data fees be fair and reasonable and not unreasonably discriminatory. We would urge a rethink of what "discrimination" means in the context of thinly traded securities. Our firm's traders frequently face marginal cost/value trading decisions where the fixed market data cost of a particular marketplace outweighs the *potential range* of trading profits from accessing that marketplace. We have in the past asked marketplaces to rebate us data fees based on the volume of traded liquidity we provide to them, but have been told each time that they cannot price discriminate on that basis.[2] This is unfortunate because accessing quote information at a discount or for free would constitute a powerful incentive for firms such as ours to add liquidity to thinly traded securities, with no investors or other market participants being worse off and without undermining the core principle of fair and reasonable access (as the SEC's backgrounder points out, "thinly traded securities" as defined comprise only 2% of the overall traded market). Perhaps the now-accepted exception of extending discounts to firms employing many data consumers should be also applied to those providing meaningful liquidity in thinly traded securities? If agreeable to the SEC, some form of clarifying staff notice may be sufficient to permit such change.

4. Compliance Risk. Currently our firm does not trade securities with an ADV of less than 50,000 (subject to some exceptions) for a simple reason: the gross profit margins available in such securities are usually outweighed by the additional compliance costs of answering broker and regulator inquiries. Our experience is that regulatory and brokerage surveillance systems commonly utilize a "red flag" alert based on the percentage market share a trader has in a particular stock ("participation percentage"). The assumption behind this alert is that typically any given trader or trade desk ought to be responsible for well under 10% of a stock's traded volume, such that having a participation percentage of say 20% or 30% or more of a stock's traded volume is an "anomaly" suggestive of possible market manipulation. We believe there is a fundamental unfairness built into such an assumption.

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[2] The only price discrimination currently permitted is based on the number of market data subscribers within a trading firm – the per-subscriber rate falling as the firm reports more data subscribers.

In our experience: (1) no algorithmic trading firms will trade thinly traded securities, leaving the field to humans trading manually; and (2) there will typically be a very small number of liquidity-providing firms (often only one) consistently posting bids and offers in such securities and interacting with investors and other market participants (in other words, the number of liquidity providers in a stock rapidly diminishes towards the thinly traded end of the spectrum). However, those firms who make such markets are immediately penalized by triggering significantly more surveillance inquiries per traded volume than, say, an algorithmic trading firm in a highly liquid stock. Moreover, the trading logic underlying a particular algorithm needs to be explained only once, whereas a human trader must explain his or her intention behind *each* trade or sequence of trades once he or she has triggered such an alert.

We would encourage a rethink by regulators and executing brokers of this paradox whereby more trading in thinly traded securities is inherently desirable, yet "too much" trading by a small number of traders in thinly traded securities is viewed with suspicion. This bias may be inadvertently exacerbating the very issues being considered through this comment process.

5. Market Makers. We have commented earlier[3] that the algorithmic trading revolution dramatically shifted the compensatory landscape for expensive, traditional market makers in a negative direction. While we are not at all averse to market-making programs involving broker-dealers willing to take on such a responsibility, we believe that regulatory changes ought to be geared towards incenting participation by all types of market participants, particularly those who add meaningful value and reduced all-in costs for investors.

6. Low and Zero-Percent Commission Structures. The low- and zero-commission trading offered by certain large retail brokerage houses are not conducive, and are likely detrimental, to generating liquidity in thinly traded securities. In order for retail brokerage houses to lower their clients' trading costs, they typically sell such client order flow to wholesalers who then match the orders by only providing de minimus price-improvement (that is, by capturing most of the spread where client orders are crossed). Moreover, without the continuous posting of client orders on visible markets, the overall spread for such stocks remain wider than if they had been posted. We believe that regulatory changes such as implementing an Order Exposure Rule for thinly traded securities (which would, by definition, prohibit the sale of client order flow to wholesalers) will in the long run create more liquid markets for retail investors and all other market participants.

7. Intraday Auctions. We believe that regulatory efforts should be utilized towards measures designed to create continuous intraday liquidity. Intraday auctions do not enhance

[3] https://www.sec.gov/comments/265-31/26531-3489072-162255.pdf

continuous price discovery, and are best suited for block trades (for example, blocks in excess of $100,000 in value).

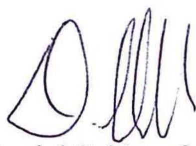
8. Off-Exchange Trades. Again, we believe the goal ought to be promotion of continuous intraday price discovery available to all market participants. Off-exchange negotiation and execution is best utilized for larger block trades.

9. Factors to Consider in Defining "Thinly Traded Securities". In Canada, a "block" for the purposes of the Order Exposure Rule and related trade-at rules is defined by both volume and value (*i.e.*, minimum of 50 board lots[4] in volume and C$100,000 in value). Our experience is that value is an equally important factor in determining the relative liquidity of a security.

   Another metric to consider is the size of a stock's spread as a percentage of either its last-trade value or the mid-point of the then-current bid-ask spread – that is, certain stocks may have an ADV of over 100,000 but are sporadically traded through the day and so may suffer from very wide bid-ask spreads. A key policy goal ought to be the narrowing of bid-ask spreads, and so stocks with statistically large spreads ought to be included in the "thinly traded" category.

   Finally, if some of the significant regulatory changes we propose above are adopted, care must be given as to how a "thinly traded security" graduates out of that category. Obviously, the ADV (and any other definitional metrics) ought to be calculated over a long duration of time (*e.g.*, two calendar quarters) to ensure any new liquidity enjoyed by a security is sustainable and will likely not be lost once the security is graduated out of such category.

Sincerely,



Daniel Schlaepfer
President

Mario Josipovic
VP, Regulatory Affairs and
General Counsel

[4] We additionally note that in Canada the size of a board lot differs depending on the value of the stock.