May 13, 2015

SEC Market Structure Advisory Committee Members
US Securities and Exchange Commission
100 F Street
Washington, DC 20549

Re: Encouraging Displayed Liquidity

Dear SEC MSAC Members,

We recommend policy makers charged with overseeing and shaping our US equity market should encourage liquidity and public price discovery. In particular, *diverse liquidity* is especially crucial.

- Robust publicly displayed liquidity inspires investor confidence. When investors can see, touch, and interact with a deep and sizable liquidity book, they are more confident entering and knowing they can exit positions/investments.

- Investors fear liquidity vacuums, volatility and "mini flash crashes". The presence of these ultra-short term liquidity vacuums detracts from investor confidence. When they are caught in such a vacuum, or even bear witness to such, particularly vacuums caused by market structure flaws, investors lose trust in the marketplace, and regulators' ability to protect them.

We urge you to consider the ramifications to displayed liquidity in your collective discussion of Reg NMS, the creation of a National Market System comprised of fragmented liquidity pools, and particularly Rule 611 (the trade-through rule that protects the best displayed quotes in those pools).

We especially urge you to adjust current rules to encourage displayed liquidity by long term investors.

Quick Background

We won't give a detailed history lesson on how liquidity in the US markets has morphed in the last 20 years. Suffice to say that there used to be fewer liquidity pools, and those pools contained diverse participation – from institutional and retail investors, as well as traders with great variety in their time horizons (seconds – minutes – hours). That does not mean every aspect of these liquidity pools was better, but certainly institutional investors felt more confident that they could access the liquidity they needed to.

Today, market participants have been segmented and cordoned off.

- **Retail Investors:** Their orders rarely make it to a public exchange. Instead, they are "internalized" by large proprietary traders, who view their order flow as non-toxic, and are traded off-exchange. These trades are given prices that reference pricing on the public markets.

- **Institutional Investors** (retail in managed money, such as: mutual funds, ETFs, 401ks): Their orders interact with a complicated web of public exchanges and dark pools through an order routing mechanism (ORM) that tends to whirl them around in the dark, in a fleeting manner. These orders also are not highly represented or traded on public exchanges.

- **Market Makers** (evolved prop traders that trade with great speed, attempting to make money through spread capture subsidized by exchange "maker" rebates): While significant players in the plethora of US dark pools, market maker orders *tend to dominate the public limit order books.*

The combination of all of the above means that the public orders books are dominated by high frequency participants that tend to be very short term in nature. Their liquidity can be very fleeting in times of stress. Their participation and liquidity provision is very wary of short term adverse selection. Their pricing is referenced by up to 40% of the trades that take place in the US stock market.

The results are highly visible liquidity vacuums and mini-flash crashes.

Shouldn't a marketplace with the most accurate price discovery – where public pricing is closely matched to an asset's underlying value, have diverse participation? Going back years, we have used our "diamond analogy":

> *If you are shopping for a diamond, would you feel more comfortable paying $10,000 in a market where one player controls 70% of the transactions or paying $10,000 in a market where there are hundreds of players, none of them dominating market share?*

This brings us to where we are today. Participants in our US markets deal with a technological arms race, conflicts of interest, fleeting liquidity in times of stress, and an ever increasing amount of trading taking place in a vast network of opaque darkness.

The public markets are considered "toxic" by varied participants. Studies point out that institutional bids and offers result in too much price movement. High frequency market makers lament that the orders sent to the exchange, outside their own, tend to be orders that have been "exhausted" everywhere else. Is this a desirable outcome of modern market structure? Did the Commission envision this when it crafted Reg NMS?

Moving Forward

A robust public market, with protections and outstanding disclosure, is the backbone of our US markets. As you ponder changes to our market structure, let your actions be guided by a spirit that recognizes this, and encourages a public market that is robust, liquid, and inviting for *diverse participants*.

The recent phenomenon of well-connected and influential firms being able to segment counterparties pre-trade, dependent on their potential short-term alpha, has been one of the worst market structure developments in the last decade.

We believe the safest markets, in good times and in times of stress, will be characterized by equal playing fields that encourage diverse participation. Such markets will be less likely to exhibit short-term market-structure-induced liquidity vacuums and flash crashes.

Tomorrow, you embark on your collective examination of US equity market structure starting with Rule 611 – the trade through protection rule. You no doubt realize that the many silos of market structure that you examine are indeed much related. Internalization in the dark is tied to Rule 611. Payment for order flow, best execution, and disclosure are also similarly tied.

As you ponder removing and changing trade through protection and potentially dismantling the National Market System, ask how doing so will affect visible liquidity on our public markets. Will an institutional investor, who already has limited incentive to display public bids and offers, be more or less likely to place public bids and offers in an environment where their order can be seen by all, and traded around? Will retail investors suffer the same conundrum?

If a goal and desire of policy makers is to create robust and diversified markets that are not perceived as toxic, please consider policies and actions that encourage public market participation by investors and traders alike.

Respectfully submitted,

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