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Via Electronic Mail (rule-comments@sec.gov)

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549-0609

RE: Securities and Exchange Commission
Release Nos. 34-72460; 73511; File No. 4-657
Notice of Filing of Proposed National Market System Plan
To Implement a Tick Size Pilot Program on a One-Year Pilot Basis

Dear Ms. Murphy,

Wellington Shields & Co. appreciates the opportunity to provide our thoughts and comments on the SEC's (SEC) "Tick Size Pilot Plan." Market structure has been severely disrupted since the implementation of Reg NMS. Currently with 12 lit markets and some 50 alternative systems or dark pools, liquidity and price discovery have been more difficult to find. In addition, the dramatic reduction in transaction size has increased the time for price discovery and added to the overall ticket costs.

The disintermediation of public orders by "High Frequency Traders" (HFT) has led to a public distrust. The core of the distrust is essentially front running, albeit in nano seconds, that has been fostered by sub penny pricing. The de minimus cost improvement provided by most HFT trading has displaced a public order interaction that could have occurred if not for HFT intervention.

In addition HFT with flickering nano second quotes has been shown to disrupt markets through what appears to be at times intentionally overloading systems with no apparent public benefit. If all quotes, whether one-sided or two-sided were made to stand for one second the nano

second time advantage would be removed. Some markets have already taken steps to level the playing field based on time and the public has reacted favorably.

Wellington Shields believes the immediate elimination of sub penny pricing and implementation of one second quotes would not adversely impact the market and would provide great benefits for public orders. These two proposals either separately or together could provide the pilot with a Second Control Group which we believe would yield immediate benefits to the market.

Comments on the Reg NMS, Decimalization and Tick Size

1. SEC – The conversion to decimal pricing was completed in April 2001. These actions reduced the allowable tick size to a penny, but did not mandate a minimum tick size. In 2004, the Commission proposed, and then re-proposed, Rule 612 of Regulation NMS to establish a minimum price variation ("MPV") of one penny.

   - = Wellington Shields Comment
   - Not having a mandatory minimum tick size provided the ability of sub-penny pricing promoting nano second front running and preventing optimized public to pubic interaction.

2. SEC – Has one penny MPV made it less attractive to become a market maker in the shares of small companies?

   - One penny MPV has not necessarily reduced market makers but anecdotally has reduced participating market makers – i.e. they post smaller minimal quotes and trade less.

3. SEC – Concerns have been expressed that decimalization, and the associated one penny MPV, may have had a detrimental impact on the trading and liquidity of small capitalization stocks.

   - One penny MPV appears to have deterred broker/dealers from being active participating market makers and actually providing liquidity. Now many provide only nominal markets and trade only opportunistically when profit seems assured.

4. SEC – Impact of decimalization on the liquidity and trading of the securities of small capitalization companies.

   - Decimalization should not have any overall material impact on markets on a secular basis. However, observing short term structure for liquidity and transparency, it is clear

both have been impaired. Penny ticks discourage disclosure. Transparency and liquidity has decreased because of HFT's siphoning trades into dark pools due to sub-penny pricing increments.

5. SEC – Post decimalization, evidence of a decline in quoted depth on average, smaller trade sizes and an increase in the total time to work institutional orders.

   - Reduced depth size in quotes means less efficient markets. One cent ($0.01) trade variations give no sense of urgency and therefore a reluctance to declare interest through bids and offers. Longer execution time, as well as drastically reduced trade size, equals difficulty in finding liquidity.

6. SEC – Support for a pilot program is not universal given that an increase in minimum tick sizes may raise costs for investors.

   - Not necessarily, if you are a liquidity provider there is no added cost to execution and a larger tick size can promote more disclosure by "hidden" orders. For liquidity takers the increased tick size will attract larger two sided quotes and incent those looking for instant executions. The takers will give up price improvement for liquidity. A fair exchange.

Tick Size Pilot

7. SEC – Control Group. Pilot Securities in the Control Group shall be quoted at the current tick size increment, $0.01 per share, and trade at the increments currently permitted.

   - Control Group – Sub-penny pricing should be eliminated in the Control Group so as to observe any changes in HFT behavior. Eliminating sub-pennies would have a de minimus effect on retail order flow and returns market pricing to SEC original reference of 2004 MPV of $0.01. This would only be for transactions and not affect average pricing etc.
   - This still leaves the Control Group with market structure as it is now, but eliminates an anomoly (sub-pennies) never intended with the SEC mandate of decimals.
   - Another alternative is to leave the Control Group as proposed, but run a Second Control Group with the elimination of sub-penny pricing.

8. SEC – Test Group One would be quoted in $0.05 minimum increments. Trading could continue to occur at any price increment that is permitted today. Significant percentage of Pilot Securities have bid-ask spreads greater than $0.05.

- A $0.05 quote without trading increments of $0.05 as well most probably will drive more volume to the dark pools as the incentive is far greater for HFT front running. With a market quote of $0.05 to $0.10 an HFT can buy stock at 5.25 cents (since trading increments do NOT change) and sell at 9.75 cents and capture a far larger spread than currently available with less risk and greater potential gains. That is a 1/4 cent risk vs a 4½ cent gain. As you get added liquidity around the $0.05 quote you may get clusters that incent HFT to trade more due to added protection in case they need to reverse. Additional HFT trading is not necessarily a liquidity provider as they do not post "real" quotes but rather use speed to front run for opportunistic trading to interposition themselves.

9. SEC – Test Group Two would be quoted in $0.05 minimum increments, and traded in $0.05 minimum increments subject to certain exceptions [Exception] (1) trading could occur at the mid-point between the national best bid or offer ("NBBO"). [Exception] (2) retail investor orders could be provided with price improvement that is at least $0.005 cent better than the NBBO. [Exception] (3) Negotiated trades may trade in increments less than $0.05.

   - Exception #1 provides price improvement for a liquidity taker but prevents public order interaction with a liquidity provider assuming the mid-point is provided by HFT front running a public order. This is not necessarily a market benefit.
   - Exception #2 – All pricing should be in $0.05 ticks to attract liquidity clusters and market makers. Unless there is a pure Test Group that mandates MPV of $0.05 there is no valid Tick Size Pilot. Exception #2 destroys the validity of Test Group Two.
   - Exception #3 is appropriate.

10. SEC – If the minimum quoting increment is changed without corresponding changes to the minimum trading increment, market participants may be hesitant to display liquidity because of the ability to step ahead of wider quotes. A test group should be established to examine this potential impact on displayed liquidity in conjunction with Test Group One. Negotiated trades by their definition would not be at the NBBO or a $0.05 increment price improvement to the benefit of retail investors.

    - To effectively assess wider ticks from every perspective the tick and the transaction price should match. In a 1 cent market environment transactions could trade in 1 cent increments. In a 5 cent market, transactions should trade in no less than 5 cent increments. It is also possible to use other increments e.g. 2 cent quotes and 2 cent transactions. It could even be 10 cent quotes and 10 cent transactions or greater in the case of high priced stock with volatility.
    - Negotiated trades, average price trades, etc. are exceptions. Penny jumping or sub-penny pricing in dark pools should be eliminated. Wider spreads and wider trading increments lead to increased risks for "hidden orders." The more liquidity shown the

more the "hidden orders" will be disclosed as to not miss opportunity. The more public to public interactions and the more dealers will participate actively.

11. SEC – Test Group Three would be subject to a "trade-at" requirement to prevent price matching by a trading center not displaying the NBBO. Under a "trade-at" requirement, a trading center that was not displaying the NBBO at the time it received an incoming marketable order could (1) execute the order with significant price improvement (such as the minimum allowable $0.05 increment or the mid-point between the NBBO), (2) execute with significant size improvement if the size of the order was of block size or (3) route intermarket sweep orders.

    - "Trade-at" protects lit markets from further deterioration with requirement that also allows meaningful exceptions for significant price improvement. This should improve liquidity declaration and be a disincentive for "hidden orders." In addition precedence based on size, a hallmark of the auction market, makes sense as it promotes size disclosure and enhances liquidity location.
    - However, using the mid-point pricing encourages dealer intervention without having previously declared. This disintermediates public orders without significant benefit and it disadvantages a liquidity provider. Using a minimum $0.05 increment makes valid market sense.

Recommendations and Final Comments:

Interim recommendations in keeping with SEC rules that could improve markets with no evident market dislocation.

1. End sub-penny transactions across the board immediately in pilot groups. This will eliminate nano second front running, the root cause of market distrust today.
2. All quotes as well as individual bids and offers must be good for ONE second.
3. The two recommendations combined would not only eliminate front running but also end the quoting games and short term system dislocations through hyperactive message traffic.

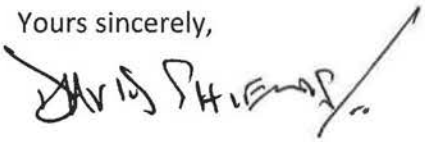
    - The time frame for setting up the Tick Pilot and its one year duration as well as post pilot analysis might prevent any market changes deemed advisable from being implemented for two years. The markets cannot wait that long.
    - The elimination of sub-penny pricing as well as a one second requirement for all quotes and bids and offers can be tried in tandem or individually immediately with no market risk. These changes do not impact the basic market structure presently in place.
    - Since there is no market structure impact, the use of a Second Control Group i.e. eliminate sub pennies and mandate one second quotes (either separately in two pilots or together in one pilot) could be easily implemented and would be recommended. It is

important to end the disintermediation of retail orders due to use of sub-pennies as soon as possible to begin restoring public confidence.

In the current environment there is no doubt that small retail orders have been served by speed and narrow spreads. However, the fragmentation and lower trade size has severely damaged liquidity and transparency. These hallmarks are essential to a broad deep effective market. We believe the suggestions offered here can help restore these fundamentals.

Wellington Shields appreciates the opportunity to comment on the Tick Size Pilot and other areas of the National Market System. We would be pleased to offer any amplification to our comments. Thank you for your efforts on behalf of our National Market System.

Yours sincerely,



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