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Professional Equities Trading
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December 22, 2014

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NW
Washington, DC 20549

Re: Tick Size Pilot Program (File No. 4-657)

Dear Mr. Fields:

Bright Trading, LLC appreciates the opportunity to comment on the tick size pilot program. We appreciate the Commission's efforts to improve market quality in small-capitalization companies.

Bright Trading, LLC has been registered in the US as a broker dealer with the Securities and Exchange Commission since 1992 and is also a member of the Chicago Stock Exchange. Bright is in the business solely for trading its own members' accounts and does not solicit nor accept orders from customers.

Bright Trading has noticed a lack of trading interest in the small and mid-capitalization companies, and believe this is primarily due to a lack of liquidity caused by the discouragement of limit order traders. We cite two main reasons for this phenomenon:

<u>Algorithmic Penny-Jumping</u>

Many small-capitalization companies trade with very wide spreads, which should be attractive for market makers to trade because of the potential profit opportunity from the wide spread. However, algorithmic penny-jumping programs appear to dominate these securities discouraging other participants from providing liquidity.

For example, assume stock XYZ is trading with a spread of $25.00 x $25.20.

If a market participant places a bid at $25.01 to tighten the spread, the algorithmic penny jumping program will automatically bid $25.02. If the original participant raises their bid to $25.03, the algorithmic program will raise its bid to $25.04. If the original participant cancels their bid, the algorithmic penny-jumping program cancels their bid as well, and the best bid returns to $25.00. The penny-jumping program is designed to battle for the top of the order queue, so as to be first to interact with incoming marketable order flow, giving it the best chance to capture the spread.

The dominance of this penny-jumping program discourages other participants from providing liquidity, which keeps the spread on these securities artificially wide.

We believe the tick size pilot will help to address this issue.

However, there is a more pressing issue that will not be sufficiently addressed in the tick size pilot.

Broker-Dealer Internalization and Payment for Order Flow

The biggest issue that our traders cite is their inability to get filled on their limit orders, even when they are at the top of the order queue. This is primarily caused due to over the counter (OTC) market makers intercepting marketable order flow that would otherwise interact with the trader's displayed limit order. In our comment letter to the Commission back in June of 2010[1], we cited this issue and recommended that the Commission require an OTC market maker internalizing a retail order to provide "meaningful" price improvement over the displayed quote.

We commend the Commission in attempting to address this issue by including a trade-at prohibition in Test Group 3 of the tick size pilot. However, we believe that the trade-at prohibition is compromised due the following exception:

(3) The order is a Retail Investor Order executed with at least $0.005 price improvement

Bright Trading LLC strongly objects to this exception as we believe it undermines the entire trade-at study.

The Commission stated in its Concept Release on Equity Market Structure that nearly 100% of retail market orders are routed to OTC market makers.[2] Retail market orders are attractive for market makers to trade against because they are typically more uninformed with regards to short term price movements. This valuable order flow is being segregated away from the public exchanges, thereby discouraging traders from providing liquidity in these securities as they are not allowed to interact with this retail order flow.

This increases the toxicity levels on the exchange, leaving market makers on the exchange to interact with more informed order flow, much of this from high frequency traders. This increases adverse selection risk, and traders quote wider (or don't quote at all) because of this increased risk.

[1] See http://www.sec.gov/comments/4-602/4602-29.pdf for a letter to the Commission discussing our concerns with broker-dealer internalization.
[2] See http://www.sec.gov/rules/concept/2010/34-61358.pdf, page 21

We strongly believe that the lack of displayed liquidity in the small cap space is primarily due to the rise in off-exchange trading and broker-dealer internalization. Displayed market makers are setting the price, but not getting the reward of getting the execution on their limit orders. This discourages participants from placing passive limit orders on the exchanges, which at certain levels, may impair public price discovery.

A study published by the CFA Institute in October 2012 on dark trading showed that when the majority of trading in a stock (greater than 50%) occurs in undisplayed venues, market quality deteriorates. The CFA Institute said,

"When dark markets dominate, such that most orders are filled away from lit markets, a mass of investors could withdraw quotes because of the reduced likelihood of those orders being filled on acceptable terms. Consequently, limit order submission declines, and displayed spreads begin to widen, resulting in deteriorating market quality."[3]

When Bright Trading, LLC studied the TRF market share in 2012 (average daily volume under 1 million), we found 1,927 stocks that had a TRF market share above 50%. It is in these stocks where price discovery is impaired and market quality continues to decline. Internalizers dominate trade in these securities.

We would recommend that the Commission remove the retail investor order exception, which would push more retail flow onto the exchanges, reducing the toxicity levels, and help to encourage displayed liquidity providers.

Bright Trading, LLC also notes that the trade-at rule is very complex, and there may be other unforeseen methods for traders to work around this rule. We would be very interested in the study of a much simpler approach. Therefore, we recommend that the Commission consider a fourth test group studying the direct effects of off-exchange trading.

<u>Proposed Test Group Four - Restricting Payment for Order flow Arrangements and Simultaneously Removing Access Fees</u>

A much simpler approach would be to run a test group that restricts broker-dealer internalization and these payment for order flow arrangements altogether, to test to see if market quality improves in the underlying securities.

This restriction however, would increase costs at retail brokerages as more of their marketable order flow from their investors would need to be routed to limit orders on the exchanges, where they would be charged an access fee.

We sympathize with the retail brokers and this is why we would recommend a simultaneous removal of access fees in the test group issues.

[3] CFA Institute (2012). Dark Pools, Internalization, and Equity Market Quality, page 58

Once again, Bright Trading, LLC appreciates the Commission's efforts to improve market quality in small capitalization companies but we believe that the tick size pilot as it is currently proposed will not help to improve market quality in these securities because we do not believe that the tick size is the primary issue. Rather, we believe that market quality has deteriorated in small capitalization companies due to rising levels of off-exchange trading and broker-dealer internalization.

Sincerely,

Dennis Dick, CFA
Head, Equity Market Structure
Bright Trading LLC