April 21, 2010

Subject: Comment 34-61358 s7-02-10

I submit two comments; one in regards to the issue of access fees and the corresponding "liquidity rebates" credited to providers of liquidity, the other in regards to the categorization of dark pool participants, particularly the role of OTC market makers, sometimes through broker-dealer internalization.

1) Under given regulations of "access fees" under Rule 610(c) of Regulation National Market System (NMS), the Commission "caps access fees for executions against the best displayed prices of an exchange at $0.003 per shares". The access fee is charged to those who "take" against resting orders, i.e. holdings of liquidity providers, and the trading center can charge no greater than $0.003 per share. The liquidity rebate is then in most cases taken as a portion of the access fee, with the difference resulting in compensation to the trading center. The amount of the liquidity rebate is then determined only by that trading center through "maker-taker" pricing models, either less the access fee resulting in a windfall for the trading center or more the access fee, resulting in so called inverted pricing, for which the trading center on paper takes the hit. Since the access fee is caped (for purposes of creating efficient and competitive markets and preventing unfair fees charged by trading centers) there is a limit on how much a trading center will most likely give for liquidity makers. Could, therefore, the ability of a trading center to attract liquidity (sellers) depend on the amount of the rebate or in economic terms, incentive to process trade with that particular trading center? If some trading centers offer better liquidity rebates than others, could this not result in a possible disproportionate amount liquidity being supplied to a few firms who can afford to provide a higher liquidity rebate – either through taking very little of the access fee for themselves or perhaps reverting to inverted pricing, thus taking revenue from another part of their operations and transferring it to this activity, providing liquidity providers with a liquidity rebate greater than the capped access fee?
2) As stated, "some OTC market makers who offer dark liquidity operate outside ATS regulations". Given the substantial amount of dark pool volume (7.9%) officially, would it not be important to better categorize OTC market makers involvement in dark liquidity, not just for regulatory purposes, but also to better quantify the total volume of dark pool trading and its overall impact, if any, on equity price volatility. Those ATSs that can operate outside Regulation ATS (access to only one person and less than 5% volume) and can restrict access to market participants may be a convenient shelter for dark liquidity. Just a thought.

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