imc
financial markets

April 21, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Concept Release on Equity Market Structure, File No. S7-02-10

Dear Ms. Murphy:

IMC-Chicago, LLC d/b/a IMC Financial Markets ("IMC") is a proprietary trading firm and registered broker-dealer, engaged primarily in the U.S. financial markets as a bona-fide market-maker, providing liquidity in nearly every listed equities and derivatives market in the U.S. In addition, IMC is part of a global firm with affiliates trading in Amsterdam, Zug, Sydney, and Hong Kong. IMC certainly appreciates the opportunity to address some of the issues raised in the Market Structure Concept Release, and hopes that its perspectives and opinions, cultured by over 20 years of global trading experience, will be useful to the Commission.

High-Frequency Trading

The proliferation of automated trading in the current market system has given rise to a new, loosely-defined category of proprietary trading firms referred to as "high-frequency trading firms." The Commission has requested comment on the role such firms play, the strategies they employ, and their general impact in the markets. As set forth in detail below, IMC believes that the presence of professional trading firms has improved, rather than detracted from, the integrity and efficiency of the U.S. markets.

Market participants, including individual investors, generally benefit from competition among proprietary trading firms. Increased competition in the markets among such professional firms provides greater depth of liquidity, helps to decrease short-term volatility, and tightens spreads. The result for investors is that they are able to buy and sell at more favorable prices at any given moment. IMC believes competition also promotes efficiency. Professional firms devote substantial resources to their exchange connectivity, pricing models, and market data, which allow them to effectively react to market inefficiencies. The benefit for all market participants is a more efficient market where pricing imbalances are corrected quickly and effectively. Similarly, competition promotes greater transparency and fairer price discovery, since pricing is dictated by a greater number of professional trading firms, rather than through a few specialist firms.

The primary source of order updates in the markets stems from market making activities that proprietary firms, like IMC, employ. Proprietary firms that engage in market making use publicly available market data to submit bids and offers, thereby providing liquidity in the marketplace at specific prices. As the Commission appropriately recognizes, proprietary firms engaging in market making are simply fulfilling the traditional role that exchange specialists held on manual trading floors. However, they are doing it more efficiently and against greater competition.

The Commission has requested comment on appropriate regulatory initiatives to mitigate the potential for abuse among high frequency firms, while not hindering beneficial strategies. IMC is a registered broker-dealer and member of most of the U.S. exchanges. As such, IMC is highly regulated, and believes that such regulation is appropriate to ensure that its operations are transparent to U.S. regulatory authorities.

Specifically, the Commission has raised the question of whether it should impose a minimum requirement on the duration of quotes (such as one second) before they can be cancelled. As a liquidity provider, IMC assumes significant risk by presenting its quotes to the market. Liquidity providers evaluate their risk in the market at any given moment based on the speed with which they can adjust those quotes. In other words, a firm's exposure when the market moves is measured by the length of time that it takes to react and update its quotes. Introducing a minimum requirement on the duration of quotes would immediately increase systemic risk for liquidity providers.

One of the primary reasons for the tight spreads enjoyed in the U.S. markets today results from the speed with which liquidity providers can react to public information (such as news, other markets, and related asset classes) and control their risk exposure. In contrast, the spreads in foreign markets with severe latency issues are considerably wider. Thus, a move by the Commission to impose latency on liquidity providers would increase their risk, forcing them to widen spreads and limit the size of their quotes. One can draw an analogy with respect to a bid to purchase a house. In an extreme example, if you force a potential buyer to keep a bid open for a year, the buyer cannot risk putting in another bid on a different house. Similarly, if during that year the market falls, the buyer will be forced to overpay when the seller accepts his open bid.

As a global firm, IMC recognizes that the U.S. markets are more evolved than, and serve as a model for regulatory initiatives in, overseas markets. As long as the Commission continues to propose and implement regulatory initiatives that are reasonable, IMC believes that the Commission's efforts will continue to improve market stability while protecting the volume of trading in U.S. markets.

Co-Location

The Commission requests comment on whether it is appropriate and fair that exchanges offer co-location services, which allow market participants to rent space to enable them to place their servers in close physical proximity to the exchanges. Co-location helps firms minimize latencies between the servers of market participants and an exchange's matching engine. The emphasis on speed to the markets is inherent to the transformation of today's market structure brought about by automated trading. Co-location allows more trading firms access to the markets with lower latencies, thereby promoting, rather than detracting from, fair and equitable access.

As the Commission recognizes, the Exchange Act applies to co-location services offered by registered exchanges, requiring that co-location services be provided in a non-discriminatory manner and at reasonable fees. As long as the exchanges continue to expand their co-location space to facilitate access to new entrants, fair access will be achieved. In order to maintain reasonable fees, prevent vertically integrated firms from unilaterally dictating prices, and promote fair competition, IMC believes that the exchanges should continue to allow multiple connectivity providers access to their co-location sites.

By providing ample space at reasonable costs, co-location opens up the playing field to allow more market participants (both large and small) the opportunity to benefit from the lower latency associated with the placement of their servers within close proximity to the exchanges. In countries where co-location is not available, the battle to be closest to the exchange still exists. However, without price controls and with more limited space in buildings immediately surrounding the exchanges, only the largest, most sophisticated institutional investors reap the benefits.

As previously discussed in detail with respect to high frequency trading, the long-term investor is actually well-served by the promotion of competition among liquidity providers benefitting from lower latencies provided through co-location services, resulting in tighter spreads and increased liquidity.

Undisplayed Liquidity in Dark Pools

The Commission requests comment on whether dark pools detract from the efficiency of the current market structure, or benefit the overall market structure. IMC believes that trading in dark pools detracts from the price transparency that the Exchange Act promotes, and the threat to price transparency will only increase as dark pools attract increasingly higher trading volumes. Furthermore, dark pools take advantage of the pricing of the public exchanges without contributing to the price discovery process themselves, using publicly disseminated quotes and prints as a reference point for the initiation of trades outside of the public markets.

The danger of allowing unfettered access to dark pools lies primarily in the unknown. While it has not happened yet, if dark pools absorb a larger and larger amount of market share, market making firms may be forced to widen their spreads to cover increased risk as trades that would ordinarily be executed in the public markets are diverted to dark pools. IMC believes that the Commission should take measures directed at increasing transparency and preventing the diversion of a significant volume of order flow from displayed trading centers to dark pools. The fact that dark pools fail to contribute to price discovery and still remain able to match a significant amount of flow within the spread that is provided on the lighted exchanges cannot be ignored.

Depth of Book Protection

Rule 611 provides trade-through protection only to quotations that reflect the best, "top-of-book" prices of a trading center. The Commission raises the question of whether it would be appropriate and feasible to expand trade-through protection to the displayed "depth-of-book" quotations of a trading center.

A new requirement that trading firms comply with the same trade-through protection for displayed "depth-of-book" quotations would be extremely complex and costly for trading firms. Most algorithms and third-party market data providers do not constantly evaluate the complete book depth of a stock. Expanding this scope would be a major undertaking, which IMC believes would not be justified in light of the "top-of-book" protections already in place under Rule 611. Although it is possible to trade through deeper orders with the use of an Intermarket Sweep Order, IMC believes implicit depth of book protection currently exists with the implementation of Rule 611. IMC believes that top-of-book protection fulfills the spirit of Rule 611, by enforcing full connectivity between trading centers and fostering best price execution on both sides of the trade.

Tick Sizes

While the historical move to decimalization was a significant benefit for long-term investors and serves as a foundation of our current market structure, IMC believes that the commitment to the investor would be further strengthened by the introduction of sub-penny tick sizes on securities based on certain pricing thresholds. Tighter pricing tends to promote more efficient price discovery, create better transparency, and increase confidence.

Odd Lot Orders

IMC believes odd lot orders often represent customer interest to a larger extent than round/mixed lot orders. Retail interest in high-priced securities is often represented as odd lot orders, and constitutes a particularly significant portion of the interest in higher priced securities. Currently, most exchanges already show odd lots in their native market data and have included the matching of odd lot orders within the normal price/time priority of its engine. As such, odd lot orders should be exposed and executed in the same way as round/mixed lot orders, removing any differential treatment and necessarily distinguishing odd lot orders altogether.

ETFs

As the number of Exchange Traded Funds (ETFs) continues to increase and becomes a more prolific tool for both the institutional trader as well as the traditional long term investor, IMC believes ETFs should be recognized and regulated in a way that recognizes that they are partially a derivative product. Regulation arising from the recently adopted SEC Rule 204 imposes obligations on market makers that are difficult to fulfill with respect to ETFs. Thus, market making firms often experience difficulties balancing their regulatory obligations with maintaining an orderly market. By treating ETFs in a way that recognizes their derivative characteristics, IMC believes that firms will be better able to fulfill both their regulatory and market making obligations, thereby resulting in a more stable environment for all investors. We believe that when forming regulations, ETF's and equities should be considered separately.

Should the Commission require further information, IMC would welcome the opportunity to discuss any of the above issues in more depth.

Sincerely,

IMC Financial Markets