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Security
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Association

April 30, 2010

Ms. Elizabeth M. Murphy
Secretary
Office of the Corporate Secretary
U.S. Securities and Exchange Commission
100 F Street, N. W.
Washington, D.C. 20549-1090

Re: **Securities Exchange Act Release No. 34-61358**
File No. S7-02-10, Concept Release on Equity Market Structure

The Security Traders Association ("STA") welcomes the opportunity to respond to questions posed by the Securities and Exchange Commission ("SEC" or the "Commission") on the SEC Concept Release, 34-61358 ("Concept Release").

The STA is a professional trade organization that works to improve market ethics, business standards, and the working environment of our members. In 1975, the Congress mandated that the SEC facilitate the development of a National Market System ("NMS"). Its goal was to assure that the securities markets in the U.S. are the most efficient and liquid in the world. The STA shares the goal of achieving the objectives of the NMS. Fulfilling the promise of the NMS serves to make the securities markets more efficient and the capital formation process more robust. This in turn benefits the economy of the nation and investors at this critical time for the United States.

Given both the maturation of Regulation NMS as well as the macro financial events of the past few years, STA supports the SEC Concept Release initiative and believes it is an appropriate time for a review of the US equity market structure. The STA is pleased to respond to the SEC request for public comment.

We completely agree with Commissioner Paredes' comment (at the SEC open meeting on January 13, 2010 concerning the Concept Release on US equity market structure):

> The analysis of U.S. equity market structure should begin with the following recognition: the U.S. has high quality markets that have performed extremely well, including during the recent financial crisis. Although price declines and volatility led to losses and unease, throughout the turmoil, U.S. equity markets opened and closed in an orderly fashion and transactions cleared.

The STA concurs that a comprehensive review of the U.S. equity market should begin with this simple fact: U.S. equity markets passed their stress test in the Fall of 2008, while some other markets did not.

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Major Findings:

We believe the questions and discussions in the Concept Release are best evaluated in the context of the current regulatory environment.

1. The equity markets are functioning properly, and there are no signs of significant deficiencies or an inability to perform their important functions.

2. All investors are protected by regulations that promote efficient market structures and foster competition between and among exchanges, marketplaces, and dealers.

STA believes, however, that at least one major deficiency currently exists in SEC oversight of today's markets. Technology has progressed so far and so fast that the traditional market surveillance systems of the Self Regulatory Organizations have been unable to keep pace. They do not receive market wide data and support regulation on a system wide basis. The SEC needs to develop a National Market Surveillance System, linked to and integrated with the technological surveillance systems of the SROs but independent of them. Regulatory gaps exist today because there is no one regulator with the capacity to technologically observe, examine and evaluate intra- and inter-market trading. We are encouraged, however, by recent SEC actions to develop a consolidated audit trail system that would capture customer and order event information across markets.

The STA has encouraged appropriate regulatory and market structure changes for decades. As noted in "The STA's Perspective on U.S. Market Structure" ("2008 White Paper"), we have consistently recommended changes with two goals in mind: the first and foremost of which is to protect investors. Our second goal has been to encourage competition between and within markets and among broker dealers.

The STA has developed a principle-based philosophy with regard to U.S. market structure and as such has "tested" the stated objectives of the Securities Exchange Act Amendments of 1975 (the "1975 Act") against today's markets and finds that the goals of the legislation have, for the most part, been accomplished. Specifically, Congress found that it is "in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure" five objectives:

1. economically efficient execution of securities transactions;

2. fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets;

3. the availability to brokers, dealers, and investors of information with respect to quotations and transactions in securities;

4. the practicability of brokers executing investors' orders in the best market; and

5. an opportunity, consistent with efficiency and best execution, for investors' orders to be executed without the participation of a dealer.

As documented in the recent report "Equity Trading in the 21st Century"[1] published by respected academics, today's markets are characterized by spreads that are down, transaction costs that are down, depth that is up, execution speeds that are faster, and overall execution quality (i.e., price improvement)

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[1] Equity Trading in the 21st Century, James J. Angel, Georgetown University; Lawrence E. Harris, University of Southern California; Chester S. Spatt, Carnegie Mellon University; February 23, 2010.

that is up.[2]

These highly competitive marketplaces have accomplished these market improvements while meeting the five objectives of Congress as set forth in the 1975 Act. Specifically:

1. Executions today occur at penny and subpenny increments, with market orders effectively executed instantaneously for individual as well as institutional investors.

2. Exchanges, ATS, OTC and broker dealers compete freely and the volume dispersed among these venues is well documented in the Concept Release. The SEC states that the Exchanges and ECNs maintain 74.6% of the volume while Non-disclosed venues like Dark Pools, OTC and broker dealers garner 25.4%.

3. Consolidated market data is readily available from the plans that consolidate it.

4. Markets are accessible and have remained functional throughout the most active, volatile and economically troubled periods of trading in U.S. History. Average Daily Volume of NYSE listed securities has almost tripled since 2005.

5. Eighty two and a half percent (82.5%) of the volume is executed on venues (exchanges, ECN's, and dark pools) designed for customer to customer interaction while 17.5% of the volume occurs in the OTC market requiring the interaction of an intermediary.

It is from the observations of experienced STA members that certain core principles concerning the interaction of markets and regulation have become apparent. The STA believes these principles, discussed below, should be applied by the SEC in evaluating the comments it receives in connection with the Concept Release.

1. **Markets evolve**. Periodic regulatory reviews are appropriate and healthy. As noted by the Congressional Oversight Panel in its January, 2009 Report:

> The essential debate… [is] between wise regulation and counterproductive regulation. Wise regulation helps make markets more competitive and transparent, empowers consumers with effective disclosure to make rational decisions, effectively polices markets for force and fraud, and reduces systemic risk.
>
> Counterproductive regulation hampers competitive markets, creates moral hazard, stifles innovation, and diminishes the role of personal responsibility in our economy. It passes on greater costs than benefits to consumers, and needlessly restricts personal freedom.[3]

2. **Incremental change is best**. We have consistently recommended that rules and regulations be changed <u>incrementally</u> to better identify and address any unintended consequences. We believe that while markets are dynamic, it is important to implement changes when the market participants are not reacting emotionally. Consequences are easier to identify in stable markets. Changes are best made in stable markets and not during politically charged times or times of financial market unrest.

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[2] Id. See "Quoted and effective NYSE and NASDAQ bid-ask spreads since 2003," slide 3.2.3. p. 10; "Retail commissions fell and remain low," slide 3.5 p. 18; "U.S. transactions costs are among the lowest in the world," slide 3.11 p.26; and "Execution times fell," slide 3.8 p. 22.
[3] "Special Report on Regulatory Reform," The Congressional Oversight Panel, January, 2009, p. 61.

Indeed, economist and author Steve Levitt and Stephen Dubner states in their book, SuperFreakanomics:

> People respond to incentives, although not necessarily in ways that are predictable or manifest. Therefore, one of the most powerful laws in the universe is the law of unintended consequences.[4]

It should be acknowledged that whatever data is examined to measure the U.S. equity market's efficiency, its performance during the Fall of 2008 must be recognized for its success and functionality. During this time of extreme stress, volatility and share volumes, the U.S. equity markets exhibited extraordinary transparency and execution efficiency. No exchange, ATS or major market center was unavailable for any significant length of time due to system overloads or antiquated technologies (unlike the 1987 crash). Increased volatility was a result of uncertainty due to counterparty risk from a major dealer collapsing and from ad hoc short sale restrictions. In short, uncertainty in the credit and derivative markets, combined with an ill-advised imposition of changes in short sale regulatory policy, imposed massive stress on the U.S. equity markets. Former SEC Chairman Christopher Cox even admitted the damage of suspending short sales, when he said "While the actual effects of this temporary action will not be fully understood for many more months, if not years, knowing what we know now, I believe on balance the Commission would not do it again....The costs appear to outweigh the benefits."[5]

And yet, considering this highly stressed environment, the equity markets and particularly the linkage systems resulting from Reg NMS, functioned admirably. While the U.S. Treasury and Federal Reserve Board stepped in to prevent a catastrophic economic meltdown, the U.S. equity markets remained open and liquid during this time through a linked marketplace, and with transparent pricing and central party clearing.

3. **Balanced competition and regulation is the correct formula**. The SEC has been shepherding the markets toward a truly national market system since 1975, through the promulgation of rules and regulations designed to encourage access and connectivity. In our 2008 White Paper, we stated that:

> The appropriate balance between regulation and competition yields the best opportunity for achieving a national market system and we believe the SEC's recent implementation of Regulation NMS was a major advancement in the quest for a national market system because it required access and connectivity, enabling competition.[6]

4. **Regulations should not favor any one business model or platform**. Regulations should be "business model neutral" and work to ensure only that investors are protected and not disadvantaged by the fiduciaries and other market participants tasked with serving their needs. The SEC should not pick "winners and losers."

5. **Enforcement**. The existing body of market and trading regulations is extensive and comprehensive. Aggressive enforcement of those rules will provide adequate investor protection and increase investor confidence more than the adoption of additional regulations. Investor confidence is damaged by every report of discovered fraud and manipulation but not as much as it is damaged by reports of inadequate surveillance and enforcement of existing regulations by the SEC. The SEC must insure that adequate resources are applied to this mission.

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[4] Steve Levitt and Stephen Dubner, SuperFreakanomics, William Morrow, 2009.
[5] Rachelle Younglai, "SEC chief has regrets over short-selling ban," Reuters, December 31, 2008.
[6] Special Report: The STA's Perspective on U.S. Market Structure, May 2008, p. 14.

Introduction to Comments

The STA represents the entire spectrum of the trading community, including both buy and sell side traders, and without regard to any particular business model utilized by the firms that employ them. Accordingly, STA believes its most valuable contribution will come from reflecting the diversity of opinion among its members on the issues raised for consideration by the Concept Release. The diversity of our membership represents a core strength of STA. We seldom find unanimous support for any one position, but we work through issues attempting to gain a consensus view based upon our objective of markets that serve all investors.

The STA feels strongly that our stated principles should provide the foundation from which our comments are developed. Further, we believe the SEC, and our markets, will benefit through application of these principles in the promulgation of any rules.

It should be noted here that there are two issues in which we find broad support:

1. "Trade At" - STA finds the issue of a "trade at" rule a threat to the continued evolution of markets and the protection of investors, especially when combined with the other proposed principle of depth of book protection. The association intends to file a detailed and comprehensive letter with the SEC focusing solely on this subject in the near future.

2. Market Data Fees – STA has long held that this topic deserves a thorough review in order to assure that its objectives are both appropriate and achieved. This pool of dollars has grown along with volume, and is today a key component of market structure and thus deserving of inclusion in the Commission's review of equity markets.

The following pages reflect varying views/opinions on issues raised in the Concept Release. We hope that these positions, as expressed by industry professionals, will be received in a constructive spirit. There are important discussion points surrounding most issues. STA is proud of our markets and their performance over the past 18 months and believe that properly balanced competition and regulation will continue to yield optimum results.

The following are the responses of the constituents of the STA to certain questions raised by the SEC in its Concept Release:

Comment generally is requested on the strategies employed by proprietary firms in the current market structure.

What are the most frequently used strategies?

The most frequently used strategies vary from trader to trader and change based on the characteristics of the stocks being executed. Volume weighted average, time weighted averages, arrival price oriented strategies and liquidity seeking algorithms are all part of the toolbox of equipment used on the desks of traders on the buy and sell side alike.

Proprietary firms engaging in electronic trading utilize many strategies that provide value to the market and their customers. Some are agency based while some execute institutional orders algorithmically. Other strategies are proprietary, developed specifically to be used to trade with the firm's own capital and resources. Other market makers would have in the past. Finally, some forms of program trading may be viewed as high speed but they are definitely low frequency. In all instances, these firms addressed traditional methods of trading and adapted advanced technology to decision making and to increase the speed of order execution.

The SEC should recognize that automated strategies differ and are not, in and of, themselves, harmful to the market, as long as participants are complying with regulatory requirements and are acting in a manner consistent with high standards of just and equitable principles of trade. The advance of technology and the adaptation of the industry to it has changed traditional market making: it is now faster and electronic.

Have any of these strategies been a competitive response to particular market structure components or to particular problems or challenges in the current market structure?

One group of members believes:

– Most strategies are a competitive response to changes in market structure. Developments in automated trading have been evolving in response to market demands and are not a new or recent phenomenon. Because these strategies are responsive to changes in market structure they have proven their ability to adapt in times of extreme market crisis. The U.S. equity markets remained open throughout the crisis and continued to perform their pricing function in markets of depth and liquidity when all other markets retreated to a virtual standstill. These strategies have proven themselves to be responsive to market structure and not just profit driven algorithms that are "shut off" during challenging markets.

While another group believes:

– No. Competition drove the technological change in market structure. High frequency trading strategies are an opportunistic response to those technological advancements. Investments of financial, technological and human capital into the development of propriety strategies are made with the expectation of earning a maximized return on that investment. Once strategies are identified they proliferate and are adopted by others as traders recognize their low levels of risk and high profit potential. Eventual market saturation results in lower returns and users are forced to change strategies to obtain a greater marginal return.

Does implementation of a specific strategy benefit or harm market structure performance and the interests of long-term investors?

One group of members believes:

- The simple answer would be no. Long term investors are not harmed by such strategies. All investors benefit from a fully connected market that provides transparency, continuous liquidity and a near instantaneous execution. Additionally, long term investors benefit from current low transaction costs, implicit and explicit. Long term investor objectives are weighted toward future company performance and generally are less sensitive to intra-day price movement.

Other members believe:

- It is the belief of some investors that they are harmed when other market participants use advanced pattern recognition programs to discover their trading intentions and then trade against them. These investors consider order anticipation and momentum ignition strategies to be a misappropriation of their proprietary trading information. The SEC should examine this issue to determine if these arguments have merit, and if so, take appropriate action through enforcement of existing regulations. To the extent that problems are identified that are not adequately addressed in the current regulatory system, the Commission should consider proposing rules for public comment.

Is it possible to reliably identify harmful strategies through, for example, such metrics as adding or taking liquidity, or trading with (momentum) or against (contrarian) prevailing price movements?

One group of members believes:

– The simultaneous existence of numerous and diverse competing trading strategies creates a healthy environment in today's equity markets. Differences of opinions exist in the markets concerning the current and future valuations of securities and inevitably some investors succeed and others do not. This is the essence of a properly functioning marketplace. Only when a market participant operates outside of the regulatory structure to subvert equitable trading practices does the possibility for "harm" enter the equation. Identifying those individuals or firms and taking action against them is the appropriate function of regulators, not dictating market structures.

Another group of members believes:

– An anonymous electronic marketplace makes it difficult to identify harmful strategies while they are being used. The Commission should propose and adopt rules that prohibit strategies that target other participant's trading intentions as constituting a misappropriation of proprietary information and strictly enforce these new rules through the examination process. All market participants should be subject to market wide surveillance and standardized regulation. Statutes defining fraud and manipulation are in need of updating as are the systems and regulatory mechanisms responsible for their detection in the electronic high-speed markets of today.

Do commenters believe that the overall use of harmful strategies by proprietary firms is sufficiently widespread that the Commission should consider a regulatory initiative to address the problem?

One group of members believes:

– No. The surveillance activities of self regulatory organizations and federal and state securities regulators are sufficient to identify any problems that might arise in the markets today. Harmful and illegal strategies are discovered, reviewed, and eliminated with the offending parties punished. The SEC should assume that all market participants are creating or providing some form of value to the market, and concentrate its resources on surveillance, examinations, and enforcement of regulations against those who would disobey them.

Other members believe:

– Recent reports estimate that HFT strategies earned $21 billion last year. Some of this amount would represent legitimate market maker remuneration. It is hard to believe, however, that this figure represents "normal" trading profits required to compensate for risks taken for the very short time periods during which high frequency trades are in force. Indeed, the very short term nature of HFT significantly limits the risk exposure for which high frequency traders should be compensated.

What type of regulatory initiative would be most effective? For example, should there be a minimum requirement on the duration of orders (such as one second) before they can be cancelled, whether across the board, in particular contexts, or when used by particular types of traders?

Members are in general agreement.

While differences of opinion exist, there is a high degree of agreement across the spectrum of members of the STA that placing orders and immediately canceling the same order (or group of orders) is not good for the market.

This activity taxes the resources of venues that have to display such traffic. Putting restraints on order entry, however, is problematic. Choosing a "one second" time frame is arbitrary and inflexible. There may be valid reasons for the cancellation of the order, regardless of its size. For example, an order may be cancelled and immediately re-entered at prices that tighten the spread.

– Requiring a minimum duration for orders is draconian and inconsistent with the operation of efficient markets. Liquidity providers are constantly exposed to risk when they display orders in a public forum. Setting an arbitrary minimum time that an order must be in force will expose the liquidity provider to much greater risk for which they will require greater compensation in the form of wider spreads. Liquidity providers will also protect themselves by reducing the size of their orders and consequently the depth of the market.

One solution to improving order integrity would be economically rewarding participants that do expose orders for a set duration. This strategy would create incentives and provide a workable solution. The pool of market data fees generated in the system could be used to compensate participants for the risks assumed by their display of orders for longer than a minimum time period.

This is an area in which the Commission should tread carefully as it is fertile ground for over-regulation that could disrupt current efficiently operating markets.

The use of certain strategies by some proprietary firms has, in many trading centers, largely replaced the role of specialists and market makers with affirmative and negative obligations.

Has market quality improved or suffered from this development?

Some members believe:

– Some proprietary firms are functioning in a role similar to that of traditional exchange specialists and market makers by providing continuous two-sided markets. The nature of this liquidity has clearly changed. Some feared a potential gap in liquidity given the ability for the electronic platforms to simply shut down. Evidence to date suggests the opposite – that electronic market makers remain in stress periods, even viewing these periods as opportunities. While related “obligations” have been reduced, competition serves to drive performance. Together these models have created highly efficient markets that contribute to the efficiency of the marketplace. In most cases spreads have tightened to a penny, depth of market has increased and volumes are at unprecedented levels.

Others believe:

– Markets have evolved to the point that proprietary orders are the equals of long term investor orders. Stripping the rights of long term investors and burying the obligations of market intermediaries does not constitute progress. While these rule changes have made it easier for market intermediaries to profit from their trading, they have also made it treacherous for long term investors attempting to execute blocks.

  Affirmative and negative obligations neutralize the advantages location provided. These obligations are still an appropriate response to neutralize any unfair advantages resulting from the advent of co-location.

How important are affirmative and negative obligations to market quality in today's market structure?

One group of members believes:

– Competition, not regulation, should dictate performance standards for market making. In a competitive environment, market makers are rewarded when they aggressively narrow spreads. If they do not, they will not execute trades and will either change their market making strategy to win more executions, or their business will fail.

Others believe:

– Affirmative and negative obligations serve important functions. The professional trader should be handicapped to allow a level playing field for the long term investor. Trading interests of long term investors should have precedence over similarly priced proprietary trading interests, particularly if order anticipation and momentum type strategies are being used by proprietary firms.

Or, is the collective result of many different proprietary firms engaging in passive market making a relatively stable quoted market in which there are many quotation updates (primarily updates to size of the NBBO), but relatively few changes in the price of the NBBO?

What types of data are most useful in assessing the quality of liquidity provided by proprietary firms?

A group of members believes:

– Rebates earned by liquidity "makers" are definitely helpful to the market, resulting in tighter spreads and deeper inside markets on most stocks. The improvement in the quality of the market lowers costs for all participants and is an obvious benefit to them.

While other members believe:

– Proprietary firms receive liquidity rebates for displaying their trading intentions but those rebates rarely return to investors taking the very same risk of publicly disclosing their trading intentions. The market intermediaries that investors use to access the markets normally retain these rebates. The rebates are meant to incentivize and compensate market participants for aggressive quoting and should be paid to those who actually earn them. It is unfair for the market intermediary to be compensated for the risks of publicly displaying this trading intention if, in fact, they have not assumed that risk.

Does the distribution of consolidated market data revenues pursuant to the Plans lead to the current trading center pricing schedules?

Some members believe:

– Market data revenues do lead to current trading center pricing schedules but this is not inherently bad and should be reviewed on a case by case basis. Market centers should use pricing to reward market participants that add liquidity and deepen markets.

While other members believe:

- As noted in the 2008 STA White Paper, participants in this country's equity markets have real-time access to the best quote and trade data available in stocks. Pursuant to SEC rules, this information is disseminated on a consolidated basis. Quote and trade data are collected continuously from market centers (i.e., exchanges, market makers, and ATSs) that are trading a stock simultaneously and then disseminated to the public in a single stream of information. Consolidated market information has been an essential element in the success of the securities markets. It is the principal tool for assuring the transparency of buying and selling interest in a security, for addressing the fragmentation of trading among many different market centers, and for facilitating the best execution of investor orders by their brokers.

  Debates over the treatment of market data reflect the divergent views that exist on many of its component subjects. The growth in trading volume, with its concomitant growth in the pool of money collected from market data fees, raises the sensitivity of this issue. The concerns surrounding market data fees focus on the purpose, ownership, pricing and distribution of market data.

  Market data fees are intended to be used by exchanges to pay for consolidation of the data received, distribution of the consolidated data, and market regulation. For several years there have been ongoing disputes concerning who actually owns the market data that is being sold. Most exchanges claim ownership of market data characterizing exchange market data as the totality of the information assets that each exchange creates by attracting order flow. Their point is that they believe it is the consolidation of the data that creates value. Other market participants such as members of the Securities Industry and Financial Markets Association, the Chamber of Commerce, the Financial Services Roundtable, and the NetCoalition disagree. For example, the NetCoalition claims this data is actually created by the public and brought to broker/dealers who are compelled by law to provide it to the exchanges.

  The pricing of market data may be the most controversial component of the current debate. The NetCoalition and other non-exchange market participants believe that data fees must be related to the cost of producing the data, and the SEC's Concept Release on Market Data suggests that a cost-based standard should be used in the case of fees charged by a "monopolistic provider." In a later Concept Release on Self-Regulation, the Commission reaffirmed their position that the total amount of market information revenues should be reasonably related to the cost of the market information. Most of the exchanges claim that "cost based" is not the current standard of review now or ever before.

  The pool of market data fees is significant and exchanges have begun rebating a portion of these revenues to market participants. These rebates have become an important incentive to liquidity providers in order to attract order flow and thus greater market share. The rebating of market data fees also impacts market structure as business models are created to take advantage of opportunities created by these incentives. The SEC has recognized the significant impact of market data fees noting that some SROs rebate substantial revenues to participants that contribute to creating the market data.

STA is convinced that the issues involving market data fees carry important implications for investors, exchanges and market participants, and require thorough examination. The Commission should determine how these fees should be calculated and how these fees can be utilized for the improvement of the marketplace.

<u>In addition, comment is requested on Rules 605 and 606, which were adopted in 2000.</u>

<u>Do these rules need to be updated and, if so, in what respects?</u>

<u>Do Rule 605 and Rule 606 reports continue to provide useful information for investors and their brokers in assessing the quality of order execution and routing practices?</u>

Some members believe:

– We agree with the Commission's comments in the Concept Release[7]: "The existence of strong competitive pressure to attract and retain customers encourages brokers to provide high quality routing services to their customers. In this regard, Rules 605 and 606 of Reg NMS are designed to support competition by enhancing the transparency of order execution and routing practices."

While other members believe:

– Rules 605/606 are flawed, particularly with regard to execution time calculations. In the simplest of terms, smaller firms with less homogenous exposure suffer by being forced to direct order flow to larger brokers and market centers with the "best execution numbers." In reality this may not facilitate the best possible execution. Rule 605, therefore, gives a competitive advantage to larger market centers and brokers because their larger volumes and quantity of orders enable a better sampling of execution quality. The "law of large numbers" comes into play here.[8] Given the disparity in sample sizes between small brokers and large brokers, Rules 605/606 may be flawed due to a "one size fits all" approach to regulation.

[7] P. 30.

[8] **Law of Large numbers**: In <u>probability theory</u>, the **law of large numbers** (**LLN**) is a <u>theorem</u> that describes the result of performing the same experiment a large number of times. According to the law, the <u>average</u> of the results obtained from a large number of trials should be close to the <u>expected value</u>, and will tend to become closer as more trials are performed. **The central limit theorem:** states that as the sample size n increases the distribution of the sample *average* of these random variables approaches the normal distribution with a mean μ and variance σ^2/n irrespective of the shape of the common distribution of the individual terms X_i."Standard definition of execution speed is - "Exec. Speed (secs) – The **average** time (to the 1/10th of a second) that covered orders were executed. Exec. Speed is measured from the time an order was received by a market center to the time it was executed." The mean and standard deviation of the distribution of sample means are systematically related to those of the population. As sample size increases the standard deviation of the sampling distribution of the mean (also called the standard error of the mean) decreases. Standard error is $\sigma/\sqrt{n}.$ the larger the size, the smaller the error. Also, note that mean (average) is not a robust measure of central tendency with a break-down point of 0. Which means you can make your average extremely and arbitrarily large by using a single extremely large observation.

Security Traders Association

The STA Board would recommend:

– The SEC promulgated Rules 605 and 606 in 2000, prior to decimalization and prior to the implementation of Reg NMS. We believe these execution quality rules should be reviewed and potentially updated. When considering Rules 605 and 606, the STA contends that "best execution" should remain a principles based regulatory policy. Both small order type investors and large order type investors seek the best price but they may have different investment objectives. The small order type investor currently benefits from fast executions, low commissions, and transparent broker execution statistics brought about by competition.

  The large order type investor,e.g. a mutual fund block order, may not be as concerned with speed of execution or even with low commissions. Rather, they may be more concerned with finding liquidity for the block and if they can achieve the best price possible, with minimal movement of a stock's price and minimal slippage from a benchmark. The long term investor, who may be part of a large order type or block order, may judge execution performance based on the fund's expense ratio and overall investment performance rather than from speed of execution or cost of execution. While Rules 605/606 address the small order type that is held, it cannot consider the not held order, nor should it. Discretion is a part of the investment process. Simply put, best execution may mean one thing to a retail investor with a small order type in a low volatility marketplace and something entirely different to a long term investor who is part of a mutual fund's large institutional block order in a highly volatile market.

The Commission requests comment on arbitrage strategies and whether they benefit or harm the interests of long-term investors and market quality in general.

– Investors rely on market data to accurately evaluate demand for and price their assets. Statistical arbitrage strategies seek out inefficient pricing relationships, either the same security on different venues or related securities. The statistical arbitrageur would buy the low priced asset while simultaneously selling the overpriced asset, forcing the prices back into line. Statistical arbitrage activities enhance long term market quality by keeping pricing relationships in equilibrium thus allowing investors to observe similar prices for their assets on disparate trading venues and be confident they are being treated fairly. When investors have fair access to the information they need to price their assets, statistical arbitrage strategies keep asset prices and market priced linked efficiently. When one party has access to pricing information prior to the general investor population, they have a valuable trading advantage and often times inappropriate riskless trading opportunities.

  Structural Strategies are potentially the most detrimental to current market. Liquidity arbitrage strategies seek to exploit the inherent weakness in the SIP (CQS and UQDF). Both CQS and UQDF have terrible technology and this weakness puts any firm that relies on such a quote at a disadvantage to firms that take all feeds directly. This creates a two-tiered market where large firms that can afford to take all the major feeds watch the direct feeds and then "pick-off" unsuspecting orders in the dark pools. More often than not the orders in the dark pool are retail orders and/or institutional orders. These orders cannot trade through the inside market of CQS or UQDF as viewed by the dark pool operator, but unfortunately this view is at a least 7 milliseconds behind (and more than likely 40-50ms behind). The inherit weakness in the aforementioned feeds creates many opportunities for small investors and institutions to be abused by highly capitalized high frequency trading firms. This problem was recently documented in the Wall Street Journal (http://blogs.wsj.com/marketbeat/2009/03/09/measuring-arbitrage-in-milliseconds/).

Beyond these basic statutory requirements, the Commission broadly requests comment on co-location and whether it benefits or harms long-term investors and market quality.

Does co-location provide proprietary firms an unfair advantage because they generally will have greater resources and sophistication to take advantage of co-location services than other market participants, including long-term investors?

Some members believe:

– Co-location is a great equalizer for firms that want to compete with Designated Market Makers and the bulge bracket firms that have knowledge of large orders in the market or coming to the market. Co-location is something that is available to every customer that trades on an exchange, unlike access to an exchange floor or an order desk at a firm. Barriers to entry that should not exist, however, can be created by exchanges charging exorbitant prices for co-locating. A comprehensive examination of the pricing of co-location and co-location services needs to be conducted to determine if trading venues are extracting unfair and monopoly rents that interfere with competition.

While others believe:

– Co-location must be open to all at reasonable fees. Even with non-discriminatory access to co-location services, collocation will provide place and information advantages to those who use it. These advantages will need to be monitored closely to ensure that they do not disadvantage long term investors.

Conclusion:

The STA appreciates the opportunity to comment to the SEC on its Concept Release and stands ready to provide its resources to be of assistance to the Commission in evaluating the responses it receives and actions it might consider taking in light of them. We maintain that the markets are currently operating with historic efficiency, any changes that the SEC considers should be in the nature of fine tuning, carefully considered for their impact on competition, not favor any particular business model, not pick "winners and losers" and be incremental. The U.S. equity markets are acknowledged to be the standard bearer for serving all investors by providing fairness, liquidity and transparency unparalleled in the world. It serves as a critical component of our economy and as such should be allowed to continue to evolve, driven by competition and balanced through wise regulation.

Sincerely,

Brett F. Mock
Chairman

John C. Giesea
President and CEO

CC: SEC Chairman Mary L. Shapiro
SEC Commissioner Kathleen L. Casey
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