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May 5, 2010

VIA ELECTRONIC DELIVERY (rule-comments@sec.gov)
Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Concept Release on Equity Market Structure (Release No. 34-61358; File No. S7-02-10)

Dear Ms. Murphy:

Citigroup Global Markets Inc. ("CGMI" or the "Firm")[1], on behalf of itself and certain of its affiliated companies, is pleased to respond to the concept release on Equity Market Structure (Release No. 34-61358; File No. S7-02-10) (the "Concept Release") recently published by the U.S. Securities and Exchange Commission ("SEC" or the "Commission") as part of its broad review of current equity market structure.

CGMI participated in the preparation of a separate comment letter on the Concept Release submitted by the Securities Industry Financial Markets Association ("SIFMA"), dated April 29, 2010 (the "SIFMA Letter"). We generally support the analysis and views set forth in the SIFMA Letter, but are writing separately to highlight additional comments with regard to the issues below. In particular, CGMI would like to address the Concept Release's discussions related to Internalization, Alternative Trading Venues and Price Discovery, the proposed Trade-At Rule, Subpenny Pricing, and Best Execution (SEC Rule 605).

[1] Citigroup Inc. is a diversified global financial services holding company whose businesses provide a broad range of financial services to consumer and corporate clients as well as governments and other institutions. Citi has some 200 million client accounts and does business in more than 100 countries. Citi's primary U.S. broker-dealer subsidiary, Citigroup Global Markets Inc., is registered as a broker-dealer in all 50 states, the District of Columbia, Puerto Rico, Taiwan and Guam, and is also a primary dealer in U.S. Treasury securities and a member of the principal United States futures exchanges. Other Citi affiliates actively engaged in U.S. equity market trading include Automated Trading Desk (ATD) and LavaFlow, Inc. Additional information may be found at www.citigroup.com or www.citi.com.

In the ever-evolving landscape of the U.S. equity markets, CGMI believes that it is important for the Commission to periodically review and evaluate market structure, and CGMI stands ready to support the Commission and its staff in this effort. At the same time, CGMI strongly believes that the U.S. equity markets today perform at historic levels of efficiency and fairness. The dramatic improvements delivered through technological innovation have spurred greater competition in the marketplace. Such competition has resulted in better executions for all investors with lower transaction costs. As an overarching theme, CGMI is in favor of an equity market structure that levels the playing field for the investing public and drives competition through technological innovation, to the ultimate benefit of long-term investors. That said, CGMI is of the belief that the Commission should focus its efforts on the current laws, rules and regulations restraining manipulative or disruptive behavior, while allowing advancements in the facilitation of customer orders to continue to benefit long-term investors.

CGMI urges caution in adopting rules without sufficient empirical data or analysis supporting their beneficial impact on the market. It also seems clear to CGMI that a more global approach to regulation and coordination among the exchanges of the world would result in more uniform practices and policies. This can only serve to benefit long-term investors and capital raising by issuers. It would also help prevent regulatory arbitrage, and so we urge the Commission to coordinate its approaches to regulation of the U.S. equity markets with its global counterparts.

I. Internalization

The Commission asks a number of questions in the Concept Release regarding internalization of order flow by broker-dealers. CGMI believes that internalization helps provide demonstrably better execution quality to investors. To understand this dynamic interaction, we must first understand how market participants attempt to attract order flow, and, more importantly, why.

Today, competition for order flow is fierce. The for-profit exchanges fight with various pricing schemes to increase their market share. Broker-dealers compete for customer business by providing enhanced execution, by committing capital or by increasing crossing opportunities within their own liquidity pools. Alternative liquidity pools seek to attract order flow to increase their own market share and long-term viability. Accordingly, this competition creates more opportunities for price improvement, size improvement and quick executions than at any other time in the market's history. Any attempt to artificially restrict internalization will result in a less efficient market place, with a corresponding negative impact on the quality of executions.

Internalization is a direct benefit to the investing public. For example, one CGMI affiliate provided more than $70 million in price improvement on approximately 29.3 billion shares in

2009.[2] Moreover, internalization also helps to dampen volatility by providing size improvement opportunities to customers. CGMI and its affiliates are just one of several market participants that offer such price and size improvement opportunities to investors. The fierce competition engendered among market participants to attract order flow has resulted in many benefits to the investing public. Spreads are tighter, price/size improvement opportunities abound, and costs have decreased. With such obvious benefits to investors, internalization should not be artificially constrained to the benefit of the for-profit exchanges, such as through the implementation of a Trade-At rule (please refer to Section III below).[3] Unnecessary restraints on internalization will reverse these benefits, and will likely result in increased volatility and significant disruption to the market.

II. Alternative Trading Venues and Price Discovery

The Commission asks a number of questions in the Concept Release regarding the potential impact on price discovery by alternative trading venues (also known as "dark pools"). CGMI believes that alternative trading venues have long been a natural part of the price discovery process, and their use does not impair the public display of quotations.

Some argue that undisplayed liquidity has widened spreads. CGMI does not believe that empirical evidence supports this argument. In fact, spreads have narrowed considerably in recent years. Currently, the majority of executions occur within spreads of a penny or less. Most of the orders residing on dark pools would not be publicly displayed in their entirety in any event. Market participants can and do use undisplayed liquidity on all market centers. Restricting undisplayed liquidity will not automatically convert such orders into "lit" quotations. Rather, market participants use alternative trading venues for a variety of reasons, including the prevention of information leakage. Large orders will not automatically go bright in the event that further restraints are placed on alternative venues.[4]

The SEC recognized the interplay between public display of quotations and the rationale desire to prevent information leakage in the limit order display rules. Under those rules, larger orders are not automatically subject to the display requirement. With Regulation NMS, the SEC

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[2] Statistics are derived from data reported to Thompson Reuters.

[3] *See generally* Robert L.D. Colby and Erik R. Sirri, "Consolidation and Competition in the US Equity Markets", Capital Markets Law Journal, Vol. 5, No. 2 (2010) ("Colby/Sirri Article") (arguing that order-consolidation requirements should be relaxed when this benefits individual investors).

[4] *See generally* Colby/Sirri Article ("Deconsolidation of orders should be permitted in situations where the customer will never permit its orders to be consolidated or to be exposed to the public.").

updated market structure again by requiring that the Order Protection Rule (SEC Rule 611) (the "OPR") apply equally to all market participants. Therefore, the SEC found a balance between protecting orders from being traded-through with the need to limit the amount of information required to be publicly disseminated, especially with respect to larger orders. CGMI believes that this balance remains effective and does not need to be disturbed.

We believe there may well be some tipping point where so much of the market is represented by undisplayed liquidity that spreads will widen. We believe that the markets are not close to that level now, and may never be. Our rationale is that basic economics suggest that most lit quotations will not go dark. If spreads widen because "too much" volume is undisplayed, then there will be an economic incentive for market participants to place "bright" liquidity to attract order flow (and, of course, if priced appropriately, displayed liquidity will take precedence over undisplayed liquidity on that trading center). CGMI believes that the market has found an equilibrium with respect to the amount of displayed versus undisplayed liquidity, and thus no further regulatory intervention is required.

III. Trade-At Proposal

The Commission asks a number of questions in the Concept Release regarding a possible "trade-at" rule. Such a rule would require a trading center not displaying the national best bid/offer ("NBBO") at the time it received an incoming marketable order either to execute the order with significant price improvement (e.g., the minimum allowable quoting increment), or route inter-market sweep orders ("ISOs") to the full displayed size of NBBO quotations and then execute the balance of the order at the NBBO price.[5]

As discussed above, CGMI believes that the quality of public price discovery has not been substantially harmed by non-displayed liquidity. CGMI joins SIFMA and its member firms, the Investment Company Institute (the primary trade association for the mutual fund industry ("ICI")), and several others in the industry who have previously submitted comment letters on the Concept Release, in strongly opposing the concept of a trade-at rule.[6]

As SIFMA notes in more detail in its letter, a trade-at rule would stifle innovation. Many of the new business models that have been introduced into the markets during the last decade could not exist under such a regulatory regime; this would work to the detriment of all investors. For example, the rule would significantly impact the ability of investors, including long-term

[5] Concept Release at 3613.

[6] *See, e.g.,* SIFMA letter, ICI letter, STA letter, BATS letter, DirectEdge letter, TD Ameritrade letter, Knight letter, BNY letter, CSFB letter, and several others.

investors, to use non-displayed trading venues to handle sensitive order flow. The requirement that such a venue offer price improvement at least in the amount of the minimum increment would result in the loss of millions of dollars in price improvement to the retail investor. Further, the routing of ISOs to the full, displayed size of NBBO quotations would subject such market centers to access fees and significantly reduce the ability of any venue to match customer orders. It should be no surprise that the largest for-profit exchanges support this proposal as more participants' orders would be forced to pay their higher exchange execution fees.[7] Such routing would also signal other market participants that such orders existed at the non-displayed trading venue, thereby increasing costs for institutional investors, especially with respect to large orders.

Furthermore, such a rule is not warranted given the relative stability of the equity markets and the absence of compelling evidence (based on empirical data) that alternative trading venues are impairing public price discovery. We also believe that a trade-at rule would have significant adverse consequences for investors, and retail investors in particular. By requiring internalizers to clear the NBBO prior to offering capital commitment, the rule will reduce the amount of liquidity readily available to the market, and could correspondingly increase volatility. This will likely be most apparent in times of market stress, when investors most need capital commitment from their broker-dealers.

In sum, a trade-at rule would undercut advances in best execution by dictating a particular manner of trading, which seems wholly unnecessary in light of the recent performance of current equity market structure. In this respect, a trade-at rule comes very close to a consolidated limit order book or "CLOB." Both would negate the competitive benefits of dispersed order flow and unnecessarily impede investor choice.[8]

IV. Subpenny Pricing

The Commission asks in the Concept Release whether it should consider reducing the minimum trading increment under Rule 612 for low-priced stocks.

CGMI believes that expanding subpenny quoting would do more harm than good to the stability of the equity markets. As SIFMA notes in more detail in its letter, subpenny pricing encourages market participants to "step ahead" of competing limit orders by an economically insignificant amount, which ultimately harms the quality of the markets. If subpenny pricing were expanded, CGMI believes that attaining priority for such economically insignificant amounts would reduce

[7] *See, e.g.,* NASDAQ OMX letter at 4; NYSE at 10-11.

[8] *See* SIFMA Letter at 12-14.

the incentive for liquidity providers to publish limit orders. It also would negatively impact the utility of order priority rules such as the OPR.

Subpenny pricing also would increase the number of available price points and decrease the depth available at the best displayed prices, rendering the NBBO less effective in reflecting true trading interest. Decreased depth at each price in turn would require multiple transactions at multiple prices to complete an order, which would increase the cost and difficulty of completing a trade. Subpenny pricing also may increase the incidence of flickering quotes.[9]

Despite this, in the event that the Commission does consider subpenny pricing, it is CGMI's view that it should be available only for stocks under a particular dollar amount threshold – for example, $2.00 per share. Conversely, for stocks that trade over a sufficiently high threshold (e.g., $20.00 per share), CGMI suggests that the Commission should consider a minimum increment in excess of a penny (e.g., $0.02, or perhaps $0.05 in higher-priced securities). CGMI believes that an increased minimum increment for high dollar value stocks would improve market quality by reducing the "penny jumping" effect that allows stepping ahead of lit orders by economically insignificant amounts. CGMI believes such an initiative would encourage participants to display more public quotations.

V. Best Execution – SEC Rule 605

The Commission asks a number of questions in the Concept Release regarding Rules 605 (execution quality) and 606 (order routing practices).

The Commission asks whether Rules 605 and 606 need to be updated and whether Rule 605 and 606 reports continue to provide useful information for investors and their brokers in assessing the quality of order execution and routing practices. Regarding Rule 605, CGMI believes that the effective/quoted percentage ("E/Q") statistic is effectively used by the industry and serves a useful purpose for broker-dealers in measuring execution quality. However, CGMI believes that most retail investors do not use the reports, nor do they understand the metrics that are used to create them.

Rule 605 does not currently require disclosure of the amount of time that canceled non-marketable orders are displayed in the order book of the trading center before cancellation. The Commission asks whether Rule 605 should require the disclosure of the average time that canceled orders were displayed in the order book. CGMI believes that this disclosure is not particularly relevant and does not provide useful information to the public. Non-marketable orders are placed without the expectation of an immediate execution. Therefore, we believe that

[9] *See* SIFMA Letter at 14-15.

the proposed disclosure of the non-marketable cancellation time statistic would not improve today's market structure.

The Commission also asks in the Concept Release whether a distinction between ISO and non-ISO marketable orders would benefit investors. We do not believe that the average long-term investor understands the term ISO, and to issue such statistics would only serve to further confuse investors and render such reports even more obscure.

Much of our analysis of Rule 605 depends on the goal of the Commission: if execution quality statistics are intended to be used by the broker-dealer community to the benefit of retail orders, then the rules seem to be working as is. However, if the goal is to make the markets more transparent to the retail investor, then CGMI does not believe this is occurring. Few if any individual investors spend the money to purchase formatted Rule 605 statistics from the vendors that publish them. Additionally, several useful metrics, including E/Q, must be derived mathematically from the published metrics. Further, the market data driven 605 metrics only consider top of book at order entry, and do not factor in what liquidity lies behind the NBBO (the depth of book), nor the trading conditions in the market at the time of order entry for the ordered security.

CGMI has often been told by buy-side firms representing average retail investors that price is more important than speed of execution. Therefore, CGMI does not believe that investors and brokers need average speed statistics precise to the hundredths or thousandths of a second. Instead, the average retail investor might benefit much more from a simplified version of the report which shows how often their trades are executed at the NBBO or better, how fast the trade is done, and whether the customer received enhanced liquidity. There is a belief in the markets that "faster is better." But in many cases, speed does not result in the best price. For example, the size of an order as compared to the NBBO is critical in determining whether speed is the most relevant factor.

With all of the above in mind, CGMI proposes two approaches for how the Commission might consider changes in Rule 605 reporting:

(1) *Current Market Practices* – under the current market structure, broker-dealers closely review and analyze Rule 605 statistics as part of their regular and rigorous review for best execution. These statistics are the fuel feeding the fierce competitive fires among execution destinations. Therefore, CGMI believes that these statistics serve a useful purpose, and generally lead to better execution quality for investors. Further, the competition to drive superior execution quality also results in millions of dollars in price improvement being delivered to the retail investor. Therefore, one view is that only small changes to Rule 605 are needed, such as:

(a) Change the definition of "limit order away" so as to take into account the distance between the limit price and the inside market in the context of the trading price of the ordered security. Currently, any limit order 10 cents or further from the inside market is "away." CGMI believes that there is a difference between being 10 cents away in a security priced over $1,000 and being 10 cents away in a security priced under $1, for example.

(b) Break down the shortest time category for percentage of orders executed within a given interval. Currently, the smallest interval is 0-9 seconds, which is too broad since nearly 100% of smaller marketable orders fall into that bucket, making it difficult to differentiate among various venues.

(c) Clarify the guidance on assigning order receipt times and market data to orders for the purposes of SEC Rule 605. Currently, the SEC allows any "neutral algorithm" for assigning market data, which CGMI feels allows firms to "improve" their statistics by developing ostensibly neutral algorithms for assigning market data or by structuring their firms to control order receipt time. CGMI believes that neither practice furthers the Commission's aim that these metrics allow for comparisons between various potential execution venues.

That said, it appears that market participants have a fair amount of latitude in determining how they will report their results, and upon what basis they will be calculated. CGMI firmly believes that market participants should not be able to choose methodologies which skew the results.

Therefore, CGMI suggests that the SEC reviews the current Rule 605 structure, and provide clarity around certain issues. For example, CGMI suggests that the SEC adopt a standard for the calculation of market data upon order receipt. CGMI recommends that all participants should calculate the NBBO to the closest millisecond post the receipt of a covered order. This standardization would help firms assure they were making fair comparisons in their regular and rigorous review of execution quality. Further, CGMI believes that the SEC should clarify what orders types should and should not be included under the definition of covered orders. For example, the SEC should provide guidance as to whether ISO orders should be considered covered orders. With relatively minor guidance, the SEC can help ensure that the Rule 605 statistics used by market participants are consistently calculated.

(2) *Investor Education* – The current Rule 605 statistics are practically irrelevant to today's average retail investor. There would likely be a vanishingly small number of retail investors that spend the time, effort and resources to decode the comma delimited files that make up the reported statistics. Even if they did spend this time, the information is so rarified that it would be of little use to the average retail investor.

Therefore, CGMI recommends that the SEC consider requiring the publication of different statistics more relevant to the retail investor. For example, retail investors are generally concerned with two primary characteristics regarding the executions on the orders they place: (1) did the order execute at or better than the NBBO; and (2) how long did the execution take to occur. Again, as noted above, faster is not always better. However, for most orders of true retail size, speed of execution is a very relevant characteristic. A simple chart or graph showing the percentage of marketable covered orders executed at or better than the NBBO, along with a chart showing the percentage of covered orders executed in second increments (e.g. 0 to 1 second, 1 to 3 seconds, 3 to 5 seconds, 5 to 10 seconds, and 10 seconds and above) would be a reasonable requirement.

Conclusion

As previously stated, CGMI strongly believes that today's U.S. equity markets perform at historic levels of efficiency and fairness. During the volatility experienced in 2008 and 2009, the equity markets traded continuously without fail. The same cannot be said for the credit markets. CGMI commends the Commission for having created a regulatory environment which allowed the equity markets to perform exceptionally well in the recent crisis. In this light, CGMI recommends caution as the Commission considers changing the current regulatory framework. If the Commission decides to explore such changes, CGMI urges the use of pilot studies to gather sufficient empirical evidence to understand the impact to the market prior to broad implementation.

In conclusion, CGMI sincerely appreciates the opportunity to comment on the Concept Release and we welcome the opportunity to respond to any questions or comments from the Commission and its staff relating to the views expressed in this letter, as well as other issues the Commission and its staff deem relevant to this analysis. Thank you.

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Sincerely,

Daniel Keegan

Managing Director

cc: Mary L. Schapiro, Chairman
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