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By Email to rule-comments@sec.gov

The Commissioners
U.S. Securities and Exchange Commission
100 F. St. NE
Washington, DC 20549

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

To the Commissioners:

I submit this comment letter in response to the Commission's concept release on equity market structure, and in response to the unusual market events of Thursday May 6, 2010.[1]

I applaud the Commission's recent interest in market structure issues, as well as its willingness to present important data concerning the evolution of the U.S. equity markets in the past decade. Further, I believe the Commission's initiative to harmonize single-security "circuit breakers" among the different equity, options and futures markets (including exchanges and ATSs) that trade a given security, or options or futures on that security, is clearly a positive step to prevent recurrence of the events of May 6, 2010. The markets have long used short pauses in trading to address temporary order imbalance situations, and the ability to call for such a pause remains beneficial even when trading for a security is dispersed among multiple trading venues. I also agree that "stub quotes" by market centers serve little if any useful purpose and can safely be abolished.

That being said, there are several additional lessons that should be learned from the events of May 6, 2010. First, high frequency trading did not cause the dramatic market decline; it was the *absence* of high frequency traders - currently the most important liquidity providers in the markets - that caused the decline. Although some media sources and politicians have been quick to blame high frequency traders, the reality appears to be exactly the opposite. For most of the day, the markets declined because long-term investors made bearish investment decisions based on concerns about economic and political uncertainty in Greece, the UK, the EU and US financial services

[1] I am a partner in the broker-dealer group at Bingham McCutchen LLP, where I advise broker-dealers, investment advisers and other financial services firms on compliance with the federal securities laws and rules. I was formerly General Counsel of Charles Schwab & Co., Inc., and previously was Assistant General Counsel for Market Regulation at the SEC. I am currently chair of the ABA Business Law Section's Subcommittee on Trading and Markets. I submit this comment solely in my personal capacity.

reform (and some investors made “black swan” investments concerning possible future market declines), as well as market maker hedging activity relating to those long-term investor trades. These fundamental market declines caused some prominent high frequency traders to “turn off” their trading systems because the markets had moved outside of the parameters addressed by their trading models. Under ordinary market circumstances, high frequency traders spot securities that are trading outside of their ordinary ranges (and outside of their ordinary relationships with other securities) and provide liquidity in those securities. High frequency traders buy stocks that have fallen to unusually low prices, and they sell stocks that have spiked to unusually high prices - as a result, high frequency traders on balance provide price stability.[2] It was the *absence* of high frequency traders that allowed certain securities to drop dramatically in price (in response to unpriced market orders to sell) on the afternoon of May 6, 2010. Today, high frequency traders have largely replaced specialists or market-makers as last resort providers of liquidity. A significant lesson of May 6, 2010 is that the Commission should not discourage high frequency trading; it should do everything it can to encourage high frequency traders to stay in the markets.

A second major lesson of May 6, 2010 is that the Commission’s Trade Through Rule, Regulation NMS Rule 611, substantially exacerbated market volatility. Because of this rule, broker-dealers could not simply send market orders to the trading venue in which the broker-dealers thought the order would receive the best execution. Rather, broker-dealers had to send “inter-market sweep orders” (ISOs) to sweep all markets. When the NYSE temporarily became disconnected from other markets (because of temporary liquidity replenishment trading pauses at the NYSE), the result was that ISOs were routed to other exchanges with little if any liquidity. And as a result, the prices of some securities dropped dramatically, in some cases as low as a penny per share.

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[2] The Commission’s Concept Release asks questions about various high frequency trading strategies, with the apparent belief that the Commission or its Staff may be able to regulate in a way that distinguishes beneficial strategies from detrimental strategies. This is not a realistic goal. High frequency trading strategies are immensely complex, and moreover, those strategies typically evolve on a daily or even hourly basis. High frequency trading strategies are not going to fall into categories that are easy to categorize, and attempting to regulate on the basis of differences in strategy is very unlikely to be successful. Several of the potentially detrimental strategies described in the concept release (momentum ignition and order anticipation) may, at least in some situations, constitute violations of existing prohibitions on market manipulation or abuse of material non-public information. As such, these strategies may be the subject of enforcement under existing law and do not require adoption of new regulations.

The Commission's theory in support of Rule 611 of Regulation NMS was that it would encourage investors to post limit orders. It seems apparent that this objective has failed - there were few if any posted limit orders to stem the price declines on May 6, 2010.[3] Moreover, Rule 611 has had the actual effect of diminishing liquidity. Prior to the adoption of Rule 611, every exchange (and many ATSs) would guarantee that they would match the best top-of-book quote available in any market - otherwise broker-dealers would not route trades to that exchange for fear of not receiving best execution. As a result, before Rule 611, a single quote at the national best bid or offer (NBBO) for 1,000 shares would result in effective liquidity of 10,000 shares or more at that quote - because as many as ten exchanges or ATSs would match that top-of-book quote. Today, with Rule 611, the opposite occurs - all of the order flow in a given security must be directed to the single exchange or ATS that posts the best quote for a security. The result has been to increase quote volatility and decrease liquidity. The Commission should request that its Office of Economic Analysis study the effect of Rule 611 as part of its examination of market structure. My belief is that an impartial examination will conclude that Rule 611 has failed in its goal of encouraging posting of limit orders, but has had the consequence of decreasing liquidity and increasing quote volatility. As such, the Commission should consider repealing Rule 611.[4]

A third lesson of May 6, 2010 was the importance of market data, and the insufficiency of the market data currently available to retail investors. Institutional investors today typically use soft dollars (e.g. their customers' assets) to purchase high-quality, real-time, depth-of-book market data. By contrast, retail investors receive much lower quality "snapshot" market data consisting only of the NBBO and last sale information - data which is obsolete literally as soon as the investors see it. On May 6, 2010, if retail

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[3] There are many reasons why investors choose not to post non-marketable limit orders; such orders effectively give other market participants a free option to trade against that investor. The events of May 6, 2010, when numerous investors had "stop-loss" orders triggered by what turned out to be a very short-term market decline, will provide a further disincentive to posting limit orders. The Commission should abandon as unrealistic the policy goal of encouraging investors to post limit orders.

[4] The Concept Release speaks somewhat disparagingly of order internalization. However, in fact internalization often has the effect of guaranteeing customers better, quicker and more certain prices than they may receive if their orders are routed (via ISOs or otherwise) to market centers that may have little liquidity at or beyond the NBBO. If the Commission studies the best execution policies and practices of broker-dealers, I believe it will conclude that generally internalization offers substantial benefits to customers, and that where internalization would not be beneficial to customers, those broker-dealers in fact do route those orders away.

investors had been able to see that there was no "depth of book" liquidity available, they might not have submitted unpriced market orders that ended up being executed at extremely disadvantageous prices. In part as a result of the market structure developments discussed above, it is often the case that as little as 1,000 or even 100 shares are available at the NBBO, and thus retail investors often have orders executed at the next levels of available liquidity, especially in low-priced stocks. It would not cost the exchanges anything to make real-time, depth-of-book market data available to all investors (although of course it would cut into the revenues they receive from the current market data monopolies). For too long, the Commission has allowed a two-tiered market to exist, in which institutional investors receive high-quality market data, and retail investors receive much lower quality market data. The Commission should take advantage of its review of market structure to make high-quality market data equally available to all investors.

In summary, the events of May 6, 2010 lead to three conclusions: 1) the Commission should encourage high-frequency trading, which is the most important source of liquidity in today's markets; 2) the Commission should repeal Rule 611 of Regulation NMS, which has failed in encouraging limit orders but has increased quote volatility; and 3) the Commission should "level the playing field" by making high-quality, real-time, depth-of-book market data available on an equal basis to all investors. I would be happy to discuss this issue with the Commission or its Staff.

Sincerely yours,

W. Hardy Callcott