December 7, 2010

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Dear Ms. Murphy,

Taking a cursory glance at the Flash Crash of 2010 illustrates the potential damage high frequency trading can cause in a matter of seconds. There is currently great negative sentiment toward HFT, caused by reaction to the Flash Crash. Any regulation would bring about great change, as some estimates have high frequency trades making up around 70% of all equity trades in the US. This is a huge number and any regulation put on to HFT would surely have a large impact on markets. I recommend that the SEC investigate both the positive and negative aspects when considering regulation. Any policy must help to avoid the next traumatic event like the Flash Crash while maintaining the positive effects of HFT such as providing liquidity and increasing market efficiency.

There are some great benefits to HFT that cannot be ignored, even by its strongest critics. The fact that so many trades happen makes HFT firms market markers. They provide liquidity to the market by buying and selling. Critics dislike that HFTs are somewhat speculative in nature, but they make up such a high percentage of trades that they are providing a liquidity long term naturals cannot. There has also been evidence proving that HFT helps to reduce spreads and has lowered commissions. Investors can move toward value investing instead of trying to capitalize on price advantages. HFTs increase in trading volume also helps markets to become more efficient, as public information will be applied to prices as soon as it is available. One last positive factor to consider is that HFTs can help to reduce volatility. High frequency traders will not make money in the long run if they are making trades above the fair value of the asset. There is an incentive to move prices to fair value and keep them there.

There is a great amount of criticism regarding HFTs today. A great portion of Americans had their first introduction to high frequency trading through the Flash Crash. Obviously this first impression would negatively influence a person's opinion of HFTs. However, much of the criticism of HFTs is baseless. They paint HFTs as evil, the adversaries of natural investors. They neglect to project how markets would be today if trading volume were to be reduced by 70%. Liquidity would be slashed, leaving large spreads and actually hurting naturals. Other critics comment on the potential for rapid price changes, such as the Flash Crash. However, in most cases it is HFTs moving prices close to fair value and helping to reflect public information. Although rare, there is the underlying possibility for the next Flash Crash, which is where legislation can step in.

The Flash Crash was stopped when the Chicago Mercantile Exchange used its stop logic in order to prevent trading for five seconds. This is all it took to reconcile the pressures from the buy and sell side. There has been some regulatory action taken to put "circuit breaker" fail safes on some stocks and certain exchanges, such as the S&P 500 stocks traded on the NYSE. However, this program should be expanded to a more comprehensive list of securities. It only took substantial trading on E-mini futures to cause the Flash Crash. Who knows if the next crash could start with another seemingly random security? A wide ranging implementation of circuit breakers is the most logical solution. That way, the many positive aspects of HFT are preserved and the main legitimate piece of criticism is addressed. Negative (uninformed) public opinion should not sway the SEC into over-regulating a misunderstood practice.

Thank you for your consideration.

Sincerely,

Scott Matthews