CODA MARKETS CODAMARKETS.COM

July 15, 2020

Via e-mail: rule-comments@sec.gov

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Commission Statement on Market Structure Innovation for Thinly Traded Securities (File No. S7-18-19)

Dear Ms. Countryman:

I am pleased that the Commission has taken the initiative to engage market participants in determining how this problem—which keeps capital costs higher and investor returns lower than they should be—may be rectified. We are recommending that the Commission better adhere to its mission by bringing auctions explicitly within its best-execution framework. Let me explain why.

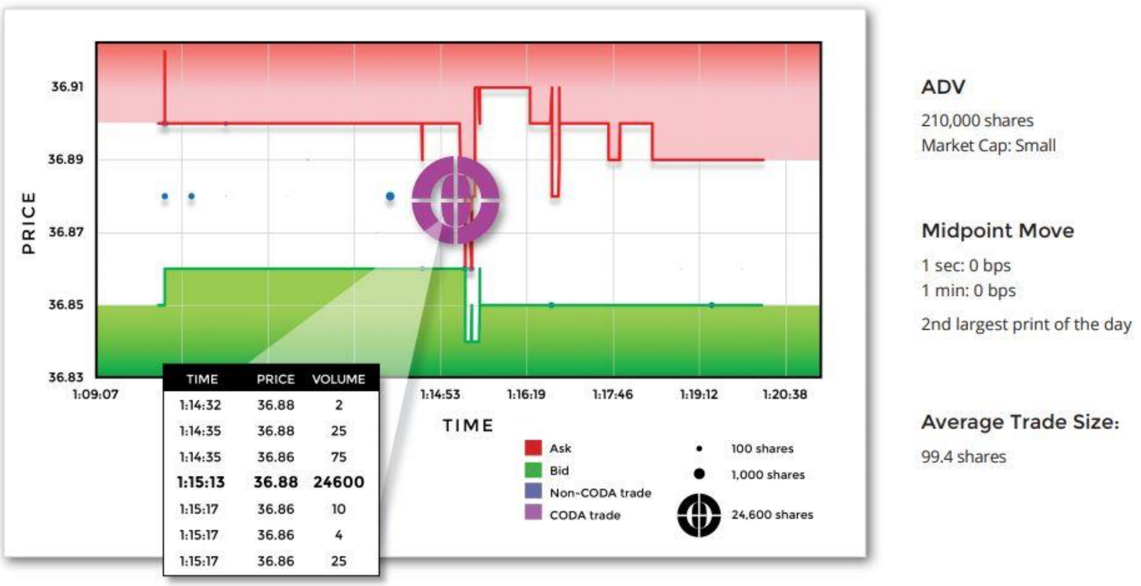
Going back to the 1970s, the Commission's efforts to improve market structure have involved an ongoing rebalancing of emphasis between *promoting competition* among trading venues, to drive down costs and encourage innovation, and *reducing fragmentation* of trading, to maximize liquidity through order interaction. Whereas the present landscape of exchanges and ATSs serves the needs of large listed companies reasonably well (albeit with greater complexity and compliance cost than desirable), it is manifestly failing those of smaller companies for whose securities trading interest is lower.

Small-cap fragmentation isn't caused by too many venues.

Let me begin by addressing the issue of fragmentation. Regulatory reform will fail to improve the liquidity of small-cap stocks so long as this issue continues to be treated as one of *spatial* fragmentation: that is, a problem of too much competition among trading venues. It is wholly unsurprising that primary exchanges would support this view, as it allows them to argue against unlisted trading privileges (UTP): that is, in support of prohibiting other trading venues from facilitating transactions in their listed stocks. Yet, as was repeatedly emphasized in the Commission's Roundtable of April 23, 2018, the small-cap fragmentation problem is manifestly *temporal*, and not spatial: that is, orders failing to meet each other in time, rather than in space. At the moment there is a buyer for a stock, there is no matching seller; when there is a seller, no buyer. Yet when natural buyers and sellers can find each other *at a specific point in time*, it is possible to achieve transactions, even in small and mid-cap stocks, of 10, 20, or even *over 100 times* what is advertised at the NBBO. Allow me to demonstrate.

My young company, CODA Markets (a PDQ Enterprises company), operates auctions on-demand throughout the trading day. That is, any participant can call an auction at any time just by indicating the stock he or she wishes to trade. Instead of trades occurring *bilaterally* and *sequentially*, as on the ubiquitous continuous limit-order books, our trades occur *multilaterally* and *simultaneously*. The result is enormous trades at net prices vastly better than could be achieved by trading those volumes through dozens of bilateral, sequential trades on continuous order books. An independent study of nearly 100,000 CODA Block auctions found no material information leakage or adverse-selection costs:
https://www.pdqenterprises.com/wp-content/uploads/2018/11/ViableMkts-CODABlockAnalysis-Oct-17-Sep-18-final.pdf

You can see an example of an actual CODA small-cap block execution below.



Here, an institution initiated a CODA Block auction for Core-Mark Holding. Whereas the average trade size for "CORE" was less than 100 shares, the auction resulted in a single trade of *24,600 shares*. It would therefore have taken about 250 trades on an exchange or ATS sequential-bilateral trading platform to accomplish what a single trade did on a CODA auction. Without revealing anything more than the stock's symbol, the auction summoned forth and aggregated substantial multilateral liquidity. Trades like these happen regularly in our venue. Small-cap trades in CODA Block are "Top 5 trades" 25% of the time.

OPR provides limited benefits for small-cap names.

Note that the Commission's Order Protection Rule (OPR) does nothing to facilitate great trades like this, since auction bids and offers are not limit orders (and therefore not protected). More importantly, treating "best execution" as trading at or within the best buy and sell limit orders represents a fundamental misunderstanding of what good trading is—from the client's perspective. A client who wishes to buy 25,000 shares of a thinly traded security should know that the inside spread is a poor approximation of the range of prices at which he or she can *complete* the purchase, as each hundred-share constituent trade serves to push that spread upward. A *block, multilateral trade* of 25,000 shares is almost sure to be better priced, *even if priced outside the spread* preceding it.

This brings me to the issue of competition. The OPR exists not just to mitigate spatial fragmentation, but to encourage competition to incumbents by guaranteeing that their best bids and offers cannot be ignored. But this has only promoted competition among *identical market structures*, and not competition among *differentiated* ones. As we should expect, then, the benefits are limited, at best. (At worst, they are net *costs*, owing to the spending required to access the spaghetti bowl of protected quotes across venues.) New structures, like ours, *designed specifically to generate small-cap liquidity*, are left outside the panoply of rules designed, ostensibly, to support capital-raising and investing.

This being the case, I am not here, like so many others, pleading for my own special privileges. I don't ask that the government mandate the use of my market, or protect it from competition. Likewise, I don't ask the government for crutches like wider tick sizes—as in an earlier failed experiment to boost liquidity by raising intermediation profits. I ask only that the Commission better adhere to its mission by bringing auctions explicitly within its best-execution framework. SEC rules currently oblige "broker-dealers to provide quarterly reports on routing of customer orders and require markets to supply monthly reports on execution quality." If such reporting required explicit consideration of auction mechanisms, including measures of their performance, *particularly as it pertains to thinly-traded securities*, investors and listed companies would be manifestly better served.

I welcome the opportunity to discuss this issue further with the SEC Staff and Commissioners.

Sincerely yours,

Don Ross, III
Chief Executive Officer
PDQ Enterprises, LLC