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Regulation of Non Public Trading Interest

As an industry veteran of over 30 years experience, and the former founder (and subsequent Manager) of Fidelity Investment's NASDAQ Trading Department, I applaud the Commission's effort to pursue transparency. However, I believe that some of the proposals embedded in File No. S7-27-09 are worthy of further comment.

My comments will be limited to the two following segments of the above proposal

1. The proposal to have "dark pools" post bids and offers publicly if the individual system exceeds 0.25% of the volume in a particular issue
2. The implementation of the size discovery exclusion for large orders.

As to the first issue, while I am in favor of increased transparencies, (such as posting actionable IOIs), I am not in favor of increased transparencies if the increased visibility negatively impacts liquidity. An element of "darkness" exists in several areas of our capital markets, from the "not held" order in the hands of the NASDAQ Market Maker, the principal amount exclusion of the SEC Order Handling Rules, or the reserve function that coexists within the ECNs. Even the registered representative has his own brand of darkness, when given the ability to enter orders in a particular stock with discretion as to time and price. Thus, there is much out there that is meant to be invisible, sanctioned by regulatory exemptions, or via an implied regulatory nod.

The heavy handed proposal to reduce the 5% volume threshold to 0.25% is flawed for two reasons. Firstly, it is so Draconian that the result will likely force liquidity away from the ATS systems that employ dark features, and there is no apparent replacement for that lost liquidity. The second reason this proposal is flawed is by suggesting the arbitrary 0.25% threshold, whose logic is simply "as opposed to zero". Because of the growth of ATS aggregators, I believe this threshold would simply force activity to be directed to the aggregators who would search for the ATS that was below the daily threshold, thereby diluting the Commission's efforts. While I am against lowering the threshold from 5%, if the threshold were to be lowered to a choice between 0.25% and zero, then my vote is that it should be lowered to zero.

As for the implementation of a size discovery exclusion for large orders, in the proposal, $200,000 was suggested as the appropriate value to define a "large order for this purpose". I believe that a size exclusion makes logical sense, and there is already precedent that supports this suggestion. The marketplace tends to interfere with executions of size, as size transparencies tend to imbalance supply and demand. While a market imperfection, unfortunately this is fact. Recognition of this fact is the ECN reserve order where the buyer may be bidding for 8000 shares but shows 500 only, and is constantly replenished upon execution. Additional recognition of this fact is that the SEC Order Handling Rules, implemented in 1996, contain a principal exclusion, whereby orders of $200,000 or more are excluded from having to be represented in the quote. This darkness, sanctioned by the SEC, still references the $200,000 threshold.

Thirteen years later, as a result of the above filing, the public is asked to comment on whether $200,000 is an appropriate threshold for principal amount exclusion. While I mention that $200,000 as a threshold has precedence, suggesting the same threshold going forward implies no apparent recognition that $200,000 thirteen years ago is no longer the same value as $200,000 today, and in my opinion, should be adjusted for inflation or some other rational basis. When a limit order of 400 shares of Google exceeds the principal threshold requiring display, it may be time to change the rules.

I suggest raising the principal threshold to $500,000 from the proposed $200,000 implied in File S7-27-09, and also re-defining the size of an institutional order, thus amending the threshold embedded in the SEC Order Handling Rules as well, so that neither exists in a vacuum and consistency exists throughout the marketplace.

Lastly, I believe that the current focus on dark pools has come about as a result of a disproportionate backlash directed at this market segment. In addition to other areas of darkness already mentioned, there are still more that exist behind the curtain. For example, market makers have routing arrangements with different customers, whereby at the same time, in the same stock, an order from Customer A has access to greater automated liquidity than Customer B, whose orders are deemed more toxic and receive lesser executions, and both customers may be receiving executions greater than the dealer’s posted bid. If it is the intent of the Commission to pursue transparency in the marketplace, then the ATS area should simply be the beginning of this effort.