July 8, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E. Washington, DC 20549-1090

RE: File Numbers:

SR-BATS-2010-018
SR-CBOE-2010-065
SR-CHX-2010-14
SR-EDGA-2010-04
SR-EDGX-2010-06
SR-FINRA-2010-033
SR-ISE-2010-66
SR-BX-2010-044
SR-NASDAQ-2010-079
SR-NSX-2010-08
SR-NYSE-2010-49
SR-NYSEArca-2010-61
SR-NYSEAmex-2010-63

Dear Ms. Murphy:

Molinete Trading Inc. appreciates the opportunity to comment on the proposals to add additional securities to the single stock circuit breaker pilot program.

Summary:

- The pilot has shown material weaknesses that at a minimum should be addressed with a minor modification before additional securities are added to the program.
- Analysis shows that the current pilot circuit breaker logic would have triggered incorrectly on 158 securities at least 238 times in the past 18 months.
- Erroneous halting of certain highly liquid and systemically important ETFs may further destabilize the markets. The analysis shows that SPY would have been erroneously halted twice in the past 18 months, potentially destabilizing the markets.
- There has not been sufficient time for the public to comment on these issues.

Current Pilot:

Before expanding a nascent (16 trading days) pilot program to include an additional 829 securities, it is important to look back at the performance of the current pilot and whether it is enhancing the performance of our markets.

In the SRO filings referenced above, the commission asked for comments on a number of important issues, including "*comments regarding the operation of the trading pause pilot to date with respect to stocks in the S&P 500*."

Our current market structure does not provide a clean and timely recording of last trade price in a fashion that is sufficiently robust to build the automated logic needed to drive stock circuit breakers. This point has been raised before in numerous comment letters to the SEC with regard to Reg-SHO and modified uptick rules (an area where the SEC recognized the weaknesses of last trading price and crafted a rule built instead off of the national best bid).

Since the existing pilot roll-out was completed on June 16th, 3 stocks have been halted due to the new circuit breakers. Of these 3 halts, 2 were clearly counter-productive towards maintaining orderly markets and having them fulfill their price discovery function. The halts of Citigroup (NYSE:C) on June 29th and Anadarko Petroleum (NYSE:APC) on July 6th have shown that the concerns expressed in our prior comment letter regarding circuit breaker logic built entirely off of last recorded trade price causing unintended stock trading halts were well founded.

On June 29th, shares of Citigroup were halted at approximately 1:03PM after 8,820 shares were reported to have traded at a price of $3.3174. As was subsequently reported, this trade report was incorrectly entered into the FINRA / Nasdaq Trade Reporting Facility, and then distributed by the Tape A consolidator (SIAC). An analysis of the trading in Citigroup immediately before the trade halt as well as the order books after the halt had been enacted showed ample liquidity on both sides of the order book. In particular, the NBBO as reported by SIAC for shares of Citigroup was a bid of $3.79 with an ask of $3.80, with tens of thousands of shares of displayed liquidity at both price points. Had a stock trading halt not been instituted on Citigroup, it likely would have been a matter of milliseconds before the next trade occurred at a price of either $3.79 or $3.80, updating the last trading price to a value in-line with the market quotes. However, by enacting a trading halt based off of a single piece of bad data, many market participants focused on the reported steep drop in Citigroup shares, and were perhaps unnerved by the perception of a 17% fall in the shares.

On July 6th, shares of Anadarko Petroleum were halted at 10:56AM due to a clearly erroneous trade processed by ARCA in which 200 shares were reportedly traded at a price of $100,000 per share. The NBBO as reported by SIAC for shares of Anadarko Petroleum immediately before and after this erroneous trade was a bid of $39.14 and an ask of $39.15. As with the stock circuit breaker enacted for Citigroup, the halt of trading in Anadarko Petroleum due to a single bad print of 200 shares was clearly counter-productive towards proper market function.

As stated in our prior comment letter (http://www.sec.gov/comments/sr-nasdaq-2010-061/nasdaq2010061-2.pdf), Molinete Trading Inc. believes that single stock circuit breakers should be constructed off of changes to the NBBO rather than last recorded trade price. If the commission chooses to continue to base single stock circuit breakers off of last trade prices, we strongly encourage adoption of a modification to the current logic such that:

- For trades reported outside of the NBBO, at least 2 consecutive trades as reported by the appropriate consolidator exceed the 10% price threshold.
- Paths in which humans can manually enter trade prices for inclusion in the consolidated tapes should be ignored for the purposes of single stock circuit breakers to prevent willful triggering of breakers by a single rogue trader.

Historical Analysis:

For the securities covered under the current pilot program as well as those the Commission proposes adding to the pilot, Molinete Trading Inc. performed an analysis to determine the frequency of clearly erroneous trades that would have incorrectly triggered trading halts. We analyzed each reported trade over the 18 month period spanning January 2, 2009 until June 30, 2010 and looked for instances of trades reported either at prices 10% or more above the national best ask, or 10% of more below the national best bid. **We have found 158 securities that the Commission proposes including in the pilot would have been subject to at least 238 erroneous trading halts on 129 days.**

In conducting this analysis, we excluded May 6th 2010 and looked only at regularly reported trades as reported between 9:45AM and 3:35PM, where the consolidated NBBO quote was not crossed. As the short comment period did not afford sufficient time to look at the trading window 5 minutes before a trade to determine the threshold price, we flagged trades that moved 10% from the closer of the national best bid and ask (i.e. bid for trades reported below the bid, and ask for trades reported above the ask) at the time of the trade. As such, our list is likely to differ somewhat from a more thorough analysis incorporating data from the preceding 5 minute window, however we believe that the results are statistically meaningful and that a similar number of securities would have incorrectly triggered single stock circuit breakers had the full analysis been performed.

We believe that many prior analyses of trade data found smaller frequencies of trades tripping the pilot circuit breakers due in large part to filtering out of trades which were either clearly erroneous, or which had been cancelled. This type of filtering grossly understates the frequency of single stock circuit breakers kicking in, as the post-facto analysis to determine that a trade is erroneous and remove it from data analyzed does not mimic the behavior of the implementation at the exchanges in which no such filtering of data is currently employed towards enacting a circuit breaker.

A listing of the number of days our analysis shows each security would have incorrectly triggered a circuit breaker is included at the end of our comments. We would be happy to furnish the Commission with our data in other formats upon request.

Inclusion of ETFs in Pilot:

The commission asked : " *If there are trading pauses in an ETF but not in the stocks that underlie that ETF, what consequences might that have for the underlying stocks or other products? What are the potential effects on price discovery for the ETF, the underlying stocks and other products?*"

While the Commission might be inclined to think that it is better to err on the side of enacting circuit breakers too frequently rather than further refining their functionality, such an approach may be quite dangerous when ETFs are added to the securities covered by the pilot program. We believe that certain ETFs are systemically important to the equity markets and that their halts if incorrectly or willfully triggered might destabilize markets.

Our analysis for instance determined that the current stock circuit breaker functionality if rolled out to the target list of ETFs would have been erroneously triggered on the S&P 500 SPDR (SPY) twice. The first instance was at 9:53AM on September 21st, 2009 and the second instance was at 11:16AM on March 31st, 2010. In the first instance, a single reported trade of 100 shares of SPY at a price of $8.23 crossed the consolidated tape, while the national best bid was $105.96 and the national best ask was $105.97, whereas the second instance was a single reported trade of 10,000 shares at a price of $20.18 while the national best bid was $117.11 and the national best ask was $117.12.

It is not clear what the repercussions of halting SPY would have been on the markets, but they might have been dramatic. SPY is one of the most liquid traded securities in the world, trading on average over 277 million shares per day over the last 3 months. Because of the tight bid-ask spreads on SPY (quite rarely above 1 penny), the depth of the order book, and the linkage with the broad S&P 500 index, SPY is used by many strategies as a hedging vehicle in making trades. As such, a halt of SPY could cause some market participants who might typically add liquidity in other less liquid equities to temporarily withdraw from the market. It is therefore not possible to rule out that an inadvertent trading halt in SPY could greatly reduce liquidity and increase volatility in other securities, leading to a chain reaction like that witnessed on May 6th.

Similar concerns exist with strategies that might use a sector specific ETF to hedge exposure to a particular security in that sector. For instance, at 11:52AM on May 8th, 2009, an erroneous print on shares of the Select Sector Utilities SPRD (XLU) would have caused a trading halt. Any strategy that was adding liquidity to one of the 35 component companies of XLU and which relied on XLU to serve as a hedge might have withdrawn liquidity for the underlying components.

We believe that inadvertent triggering of stock circuit breakers should be a high priority for the Commission, and feel that until such time as the existing conditions under which circuit breakers are erroneously triggered can be rectified, it would be imprudent to expand the current pilot program to include many systemically important ETFs.

Benefits and Risks of Excluding ETFs from Pilot:

The Commission asked for "*comments on the potential benefits and risks of excluding such ETFs from the pilot, particularly under circumstances where the securities underlying the ETF are included in the pilot. If there are trading pauses for the component securities of an index but not for an ETF based on that index, what consequences might that have for the ETF or for other products based on that index*?"

When a security is halted either because of an erroneously reported trade or extreme price volatility, market participants who trade related securities must determine their own fair value for the halted security. This process occurs daily for most of the actively traded ETFs, which trade in the pre-market and early minutes following the market open when many of their components have yet to trade. As more and more securities in an index are halted (or have yet to open in the case of the early morning), ETFs that track those securities are subject to more pricing uncertainty. This is simply reflected in wider bid-ask spreads on the ETFs to compensate the liquidity provider for the added pricing risk.

There is no reason to believe that ETFs continuing to trade while some of the underlying components are halted will in any way detract from the market.

However, as previously noted, halting an ETF can have adverse consequences on the liquidity of the underlying components of the ETF (or in the case of systemically important ETFs like SPY, the broader market).

If shares of a corporation were halted due to extreme price movements like those seen on May 6th, we should do everything possible to continue trading related and highly correlated securities. Liquidity providers rely on such related and highly correlated assets as hedging instrument to add needed liquidity, transferring risk from a series of related and correlated assets with ample liquidity to those securities lacking liquidity. Therefore a halt on ETFs which have halted components is likely to further exacerbate the underlying liquidity issues with the originally halted security ultimately amplifying the price volatility.

Comment Period:

As with the initial pilot program, the Commission is to be commended for its desire to move forward quickly to respond to the events of May 6th. While the goal of improving the functioning of our markets is well intended, the issues at hand are far too complex to be properly understood in the time periods that have been allotted.

The SRO filings to expand the pilot program to include an additional 829 securities were dated June 30th, 2010, as was the SEC's press release posted at http://www.sec.gov/news/press/2010/2010-117.htm. The press release says that the SEC is looking *"forward to receiving comments from the public on the proposed addition of the Russell 1000 Index securities and the selected exchange-traded funds to the circuit breakers",* however the public has been given only 10 days with which to furnish said comments. Given the July 4th holiday, this time period was less than 6 business days.

Many market participants are likely not aware yet that the SEC is contemplating expanding the pilot program to ETFs, and the rapid pace will surely catch many off guard. Should the SEC move forward with the pilot expansion and not address the erroneous triggering issues with the circuit breakers, the haste with which the initial pilot and its subsequent expansion have been rolled out could easily backfire causing rather than preventing a market break such as occurred on May 6th.

I encourage the SEC to reach out to a large section of the trading community (retail, institutional, HFT, statistical arbitrage, long/short hedge fund, sophisticated broker dealers) to solicit comments on this proposal before rushing forward.

Future Thoughts:

While a series of minor modifications to the current pilot (i.e. the multiplicity of trades for prices outside of the NBBO, ignoring reported trades that may have been manually entered) may make it function materially better than it has to date, circuit breakers are a sub-optimal solution to the problem of excessive volatility.

As many others have suggested, a limit-up / limit-down approach similar to that taken by the CME for would resolve most of the issues with the single stock circuit breakers. We believe that a limit-up / limit-down system would require a long lead time to develop, but that it should be the ultimate goal of the Commission and that technical discussions with market participants to outline such an approach should be started now.

In such a system, either the listing exchange or the consolidator responsible for quote dissemination would report an upper and lower limit on trading ranges. Each exchange, ECN and ATS would then be responsible for ensuring that any trades they performed (including on market orders and inter-market sweep orders) were within those bounds. This would preclude the need for trading pauses, and would prevent a triggering trade from "painting the tape" at an abnormally high or low price.

Looking at the underlying protocols utilized by the consolidators (CQS and UQDF), it is not clear that there is an easy way to add this type of functionality into the data stream. As such, limit-up / limit-down functionality would likely require protocol changes to the consolidated feeds, as well as modifications to each of the matching engines.

The complexity of the US marketplace with a multitude of exchanges, ECNs and ATSs trading the same securities under Reg-NMS makes the implementation of market-wide limits or breakers more difficult to successfully implement than in other markets. That however should not limit the choices made about how we want our markets to perform certain key functions, but should add a healthy amount of skepticism regarding the efficacy and consequences of hastily rolled out changes.

Sincerely,

Peter Skopp
President, Molinete Trading Inc.
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Erroneous Circuit Breaker Analysis:

Period: 1/2/2009 – 6/30/2010 (excluding 5/6/2010)

Symbol	Erroneous Halts
AAPL	1
ABT	2
ADBE	1
ADSK	1
AIG	4
AIV	1
AKAM	2
AKS	1
AMB	1
AMD	1
AMZN	2
ANR	1
APC	1
BAC	9
BBY	1
BHI	1
BMRN	1
BRF	1
BRK.B	1
BSX	1
C	16
CAL	1
CAT	1
CCO	1
CDNS	1
CEPH	1
CHK	1
CIEN	1
CIT	7
CLX	1
CME	1
CNA	1
COF	1
COL	1
COP	1
CREE	1
CVX	8

D	1
DBD	1
DDG	1
DELL	1
DIA	2
DLB	1
DLR	1
DNDN	3
EEM	3
EWBC	1
EWU	1
EWZ	2
EXP	1
F	1
FCX	2
FITB	1
FLIR	1
FSLR	1
GDX	1
GE	1
GENZ	1
GGP	3
GILD	1
GLD	2
GNW	1
GRMN	1
GS	1
GWW	1
HAL	1
HBAN	2
HD	2
HIG	1
HOT	1
HP	1
HPQ	1
HUN	1
IFGL	1
INTU	1
IP	1
IPG	1
IWM	1
IWO	1
IYZ	1

JCI	1
JNJ	1
JNS	1
JPM	4
KEY	2
KIM	2
KO	1
LEA	3
LEN	1
LKQX	1
LLTC	1
LNC	1
LOW	2
LPS	1
LVS	5
M	1
MBI	1
MDT	1
MGM	1
MIL	2
MO	1
MOLX	1
MON	1
MOT	1
MS	1
MSFT	1
NAV	1
NSC	1
OXY	1
PBW	1
PCLN	1
PEP	1
PHM	1
PLD	1
PNC	2
QCOM	1
RE	1
REGN	1
RF	1
RMBS	1
ROVI	1
RRI	1
RTH	2

SHLD	1
SHY	1
SIRI	4
SLM	1
SNV	1
SPG	1
SPY	2
STJ	1
SVU	1
SWK	1
SYK	1
TCO	1
TGT	2
TSN	1
TSO	1
TSS	1
UAUA	2
UFS	1
UNG	1
UNH	1
UPL	1
USB	2
UUP	1
VLO	2
VMW	1
VSH	1
WFC	4
WFMI	1
WFR	1
WLP	1
WPO	1
WYN	1
XEC	1
XLU	1
XOM	1