March 21, 2011

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File No. 265-26; Joint CFTC-SEC Advisory Committee Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to offer comments on the recommendations of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues (the "Committee") for regulatory action by the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC") (collectively, the "Commissions") in the wake of the so-called "flash crash" of May 6th, as set forth in their report entitled "Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010" (the "Report").[2] SIFMA believes that the Commissions have done an admirable job of responding to the challenges presented by the May 6th flash crash, and we applaud the Committee's efforts to continue to seek appropriate regulatory responses to the events of May 6th.

As discussed in more detail in Section B below, SIFMA supports the Commissions' efforts to date and recommends certain enhancements to existing initiatives and proposals under consideration. With the implementation of these additional modifications, SIFMA believes that the Commissions will have addressed the primary market structure issues raised by the May 6th events. As a result, SIFMA does not believe that the Committee's recommendations for more dramatic and sweeping changes to the U.S. market structure, such as a trade-at rule, are warranted. In Section A below, SIFMA discusses the many issues raised by the Committee's more far-reaching recommendations.

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[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

[2] Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010: Summary Report of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues (Feb. 18, 2011) (available at http://www.sec.gov/spotlight/sec-cftcjointcommittee/021811-report.pdf).

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A. Specific Comments

In its Report, the Committee proposes certain significant changes to the basic U.S. market structure, including, among other things, a trade-at rule with depth of book protection. As discussed below, SIFMA does not believe that such transformative measures are necessary or appropriate, particularly given their potential adverse consequences and the more targeted and effective actions already taken or being taken by the Commissions, as discussed in more detail in Section B.

1. Trade-At Rule with Depth of Book Protection

The Committee recommends that the SEC consider adopting a trade-at routing regime and requiring greater depth of book protection than today's top of book trade through protection.[3] SIFMA strongly opposes the concept of a trade-at rule as it would impact the current operation of the markets in a dramatic and adverse way. In particular, a trade-at rule would adversely affect investors and stifle competition and innovation, while imposing significant implementation costs on the markets.[4] Moreover, SIFMA believes that there is no evidence that the basic price discovery model of today's markets is inherently flawed. In fact, empirical data shows that today's markets are more efficient than ever before, with greater liquidity, faster executions, narrower spreads, lower transaction costs and more opportunities for size and price improvement, in particular for retail investors.[5] Instead, SIFMA believes that the pricing issues revealed by the events of May 6th are best addressed through targeted measures, such as the use of the limit up/limit down approach and the elimination of stub quotes, rather than a fundamental overhaul of the markets that may have significant adverse unintended consequences.

A trade-at rule would have significant adverse consequences for investors, and retail investors in particular. Retail investors are well-served by the ability of their broker-dealers to determine the best manner in which to execute their orders. Internalization practices permit broker-dealers to offer immediate executions, size and price improvement, lower market impact and very low commissions. These practices would be negatively impacted by the proposed trade-at rule. For example, broker-dealers executing orders internally currently may provide a customer with faster, guaranteed executions along with opportunities for price improvement. By contrast, a trade-at rule might instead require that same order to be routed away, both slowing the execution of the customer's order and potentially causing the customer to miss the market and

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[3] Recommendation 12, Report at 13. As the Committee notes, under a trade-at regime, "orders must be routed to one or more markets with the best displayed price. Note that in such a "trade at" regime venues would be able to retain and execute any order by improving the current price." Report at 12.

[4] Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: Concept Release on Equity Market Structure, at 12-14 (Apr. 29, 2010) (available at http://www.sec.gov/comments/s7-02-10/s70210-167.pdf) ("SIFMA Comment Letter on Concept Release").

[5] See James J. Angel, Lawrence E. Harris, Chester S. Spatt, Equity Trading in the 21st Century, at 5 (Feb. 23, 2010) (available at http://www.knight.com/newsRoom/pdfs/EquityTradinginthe21stCentury.pdf) ("Equity Trading Study").

lose the opportunity for price improvement. The Report correctly notes that the markets currently are experiencing a high level of order cancellation rates. If the SEC were to adopt a trade-at rule, market participants would be required to chase the same orders that the Committee notes as subject to high cancellation rates, thereby putting the investor at risk of no execution or an execution at a worse price. In addition, a broker-dealer routing an order to an away trading center may well incur additional costs in the form of fees for accessing the liquidity of the away market. These fees, ultimately, may be passed on to the end user customers.

A trade-at rule also may be harmful for investors seeking to manage the impact of their trading on the market price they ultimately receive in transactions. Routing under a trade-at rule may well increase the likelihood of information leakage, signaling to other market participants the possibility of additional order flow at a non-displaying trading venue, for example, thereby disrupting attempts of investors to reduce implicit costs associated with larger orders. Moreover, with the proposed trade-at rule, the risks of additional information leakage would not be rewarded with a better price, as is the case with the current Order Protection Rule ("OPR"). While routing occasioned by the OPR involves some risk of information leakage, this risk is ameliorated somewhat by the fact that the routed order receives a *better* price as a result of the routing than otherwise would be the case, as well as by promotion of the regulatory policy of not allowing a *better* priced limit order to be bypassed. This benefit would not be the case under the proposed trade-at rule; instead, customers would incur all of the risks noted above in exchange for a market price that their own broker-dealer was willing to give them at the outset. In addition, investors who prefer not to have their orders displayed or routed could miss execution opportunities should potential contra-side liquidity have to be routed away to comply with a trade-at rule. This has the potential to be particularly problematic in highly liquid securities in which the quote is in a constant state of flux.

With the introduction of a trade-at rule that effectively dictates the manner in which broker-dealers must trade, competition with respect to other best execution factors – such as market depth, reliability, and liquidity guarantees – would fall largely by the wayside. As a result, a trade-at rule would stifle innovation, making it less feasible for new business models to develop, to the detriment of all investors. Indeed, it is the discretion afforded to broker-dealers in determining how best to execute orders that has put exchanges in healthy competition with ATSs and over-the-counter ("OTC") market makers over the last decade; without it, we would not have seen the exchanges' dramatic improvements in fees, speed, reliability, and customer service in recent years. Correspondingly, price competition among trading centers would be significantly hindered by a trade-at rule. A trade-at rule would require certain quotes to be hit in various trading centers, which in turn would reduce the incentive for trading centers to provide lower cost executions by, for example, lowering access fees.

The Committee has noted, appropriately, that a change in routing associated with a trade-at rule "may entail substantial costs with respect to technology and implementation."[6] SIFMA believes that the cost to change the routing technology would be more than substantial, and notes

[6] Report at 12.

that they would have to be absorbed shortly after the industry has finished its technology changes to implement Regulation NMS. Moreover, a trade-at rule would likely lead to a deluge of additional message traffic and increased incidence of flickering quotes. The added explicit costs to trading centers and broker-dealers (not to mention the potential costs to investors described above) would likely be significant, and would clearly outweigh any of the Committee's anticipated benefits of a trade-at rule.

Finally, a trade-at rule would extend well beyond the OPR in its clear preference for investors who display orders over investors who decide it is in their best interest not to display some or any of their orders – even if they may be willing to execute at the same price as the displayed markets. In this respect, a trade-at rule, particularly if it is paired with greater protection of depth-of-book, comes very close to a consolidated limit order book or "CLOB." Both would negate the competitive benefits of dispersed order flow and competition among multiple markets, and also would unnecessarily impede investor choice. We note that the SEC has considered a CLOB in the past and determined that such restrictive trading measures were unnecessary.[7]

2. Internalized or Preferenced Orders

In a topic closely related to the trade-at rule, the Committee expressed concern about the impact of the growth of internalizing and preferencing activity on the incentives to submit priced order flow to public exchange limit order books. As a result, the Committee recommends that the SEC consider whether to require material price improvement for internalized or preferenced orders, and/or require such internalizing or preferencing firms to execute some material portion of their order flow during volatile market periods.[8] These proposals would drastically change current order handling practices of broker-dealers. SIFMA continues to believe that internalization and preferencing provide genuine benefits to the markets and their participants without detracting from the overall vibrancy of the public, displayed markets.[9] Therefore, SIFMA strongly opposes either proposed requirements.

As discussed in more detail above, internalized executions provide investors – in particular, retail investors – with a variety of benefits, including immediate executions, size and price improvement, lower market impact and very low commissions, mainly because broker-dealers retain some level of discretion over the order execution process. Moreover, certain orders submitted that are not executed immediately must be displayed via the consolidated quotation system, thereby furthering public price discovery. Given these clear benefits to investors afforded by internalization and preferencing, SIFMA believes that the Commissions

[7] For example, the SEC considered and rejected a CLOB in its rulemaking proceedings regarding Regulation NMS. *See* Securities Exchange Act Rel. No. 51808 (June 9, 2005).

[8] Recommendation 11, Report at 12.

[9] *See* Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: Market Structure Roundtable, at 8-9 (June 25, 2010) (available at http://www.sec.gov/comments/4-602/4602-31.pdf) ("SIFMA Comment Letter on Market Structure Roundtable"); SIFMA Comment Letter on Concept Release at 11-12.

would need significant evidence that such practices, in fact, impair price discovery or execution quality. SIFMA does not believe that any studies conclude that such drastic measures are warranted. Indeed, a recent study concluded the following:

> Virtually every dimension of U.S. equity market quality is now better than ever. Execution speeds have fallen, which greatly facilitates monitoring execution quality by retail investors. Retail commissions have fallen substantially and continue to fall. Bid-ask spreads have fallen substantially and remain low, although they spiked upward during the financial crisis as volatility increased. Market depth has marched steadily upward. Studies of institutional transactions costs continue to find U.S. costs among the lowest in the world.[10]

Moreover, we note that, by protecting the top of book of trading centers, the OPR is an effective supplement to the duty of best execution in policing execution quality.

Therefore, SIFMA believes that internalization benefits investors of all sizes, both large and small, and has not adversely impacted the quality of the markets. As such, we believe the cost of the proposed changes to internalization practices to investors would far outweigh any benefits and, therefore, should not be implemented.

3. Peak Load Pricing Model

In its Report, the Committee recommends that the Exchanges modify their current maker-taker pricing models by incorporating a "peak load" pricing feature.[11] The Committee posits that such "peak load" pricing would encourage the provision of liquidity in periods of high volatility. Although SIFMA agrees with the SEC's decision to evaluate the effect of maker-taker pricing on market quality,[12] SIFMA disagrees with the Committee's proposal to adopt "peak load" pricing. Not only would "peak load" pricing, in practice, fail to encourage liquidity in active or volatile market conditions, but it would introduce additional new problems to the markets.

First and foremost, SIFMA does not believe that "peak load" pricing would provide an adequate incentive to provide liquidity at the times when the markets would most need it. As the Committee recognizes, "in many periods of sudden and extreme volatility trading uncertainties may result in active traders withdrawing no matter what the incentives."[13] After all, the risk of significant trading losses in volatile markets far outweighs any savings offered by a change in fees or increase in rebates.

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[10] Equity Trading Study at 5.

[11] Report at 8-10.

[12] SIFMA Comment Letter on Concept Release at 15-16.

[13] Report at 9.

Second, SIFMA believes that "peak load" pricing ultimately would hurt retail investors. In order to encourage additional liquidity in active or volatile markets, the exchanges would need to increase rebates paid to liquidity providers. We believe it highly likely that, to continue to make a profit, the exchanges would increase access fees for liquidity takers. These fees, ultimately, may well be passed on to retail investors. Thus, increased access fees may drive more investors to trade at internalizing firms.

Third, although the proposal may have some academic appeal, SIFMA believes that the proposal introduces a variety of practical implementation difficulties. For example, it will be difficult for the markets to identify prospectively when peak loads may occur, and even more difficult for market participants to plan any business changes based on when peak load periods occur. In addition, such pricing would lead to substantial additional data message traffic. On a real-time basis, markets would need to identify "peak load" trading periods, and communicate pricing changes for those "peak load" periods.

Finally, SIFMA previously has expressed concern that maker-taker pricing distorts the economic spreads for stocks.[14] For instance, for stocks trading in penny increments, a taker fee can represent up to a 50-60% mark-up from displayed prices. The introduction of "peak load" pricing would exacerbate this distortive effect on stock prices even further. Therefore, SIFMA believes that the Commissions should address the liquidity issues in volatile markets directly through the use of circuit breakers and limit up/limit down protections (as discussed below) rather than through complicated fee structures that are unlikely to incent market participants to provide liquidity at the most critical times.

4. Market Making Incentives

In its Report, the Committee also recommends the use of incentives, such as differential pricing or preferential co-location provisions, to encourage high frequency traders and other persons who engage in market making strategies to regularly provide buy and sell quotations that are reasonably related to the market.[15] The Committee reasoned that such incentives may enhance liquidity, particularly in those moments when it is most needed. As an initial matter, SIFMA notes that not all high frequency trading strategies involve market making activity, an important consideration with respect to the scope of any regulatory initiatives. More importantly, SIFMA does not believe that incentives such as those discussed above would have the intended effect. As past experience with market maker quoting obligations highlight, quoting requirements do not operate to ensure liquidity, particularly in volatile markets; the risk of quoting can be too great to market participants.[16] Moreover, SIFMA believes that a significant issue in the liquidity drought on May 6th was the lack of confidence of market participants in published market data. Without reliable market data, firms will not be willing to commit capital

14 SIFMA Comment Letter on Concept Release at 15-16.

15 Recommendation 9, Report at 10-11.

16 Report at 10.

to the markets regardless of the incentives offered by trading centers. Therefore, SIFMA recommends that the SEC consider how to better ensure the quality of market data and generally seek other ways to ensure that liquidity does not flee the market, rather than looking to market makers and others who engage in market making strategies to hold back the floodgates during volatile trading.[17]

5. Allocation of Order Cancellation Costs

In its Report, the Committee highlighted the disproportionate impact that high frequency trading has on message traffic and market surveillance costs and, as a result, recommended the fair allocation of these costs to the responsible market participants.[18] Specifically, the Committee proposed imposing on those market participants with high message cancellation rates a cross-market fee based on the ratio of order cancellations to actual transactions effected by such market participant. SIFMA agrees that a high level of order cancellations does increase message traffic and surveillance costs. Conceptually, we also agree that the proposed allocation of those costs to responsible market participants is appropriate. SIFMA notes, however, that implementation details would need to be carefully crafted, including, but not limited to, determining what constitutes an order cancellation rate sufficiently high enough to justify an allocation of costs, what costs should be allocated, how those costs should be equitably allocated, and what should be done with any fees collected.

6. Reporting of Market Imbalances and Other Liquidity Information

In its 13th Recommendation, the Committee urges the Commissions to consider reporting requirements for measures of liquidity and market imbalances for large market venues. The Committee reasons that the provision of such market information may generate a response from market participants to liquidity imbalances.[19] SIFMA believes that requiring such reporting raises practical implementation issues, as well as concerns about adversely impacting competition among markets. In addition, SIFMA believes that, in considering any such reporting requirements, the Commission also should analyze how the new reporting requirements would or should affect consolidated market data.[20] If, however, the Commission determines that such real-time information is feasible, valuable and not anti-competitive, SIFMA recommends that such market data be made available to all market participants on terms that are fair and reasonable and at the same time. In times of market imbalance, no market participant should have an information advantage over others.

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[17] SIFMA Comment Letter on Market Structure Roundtable at 7.

[18] Recommendation 10, Report at 11.

[19] Report at 13-14.

[20] For example, SIFMA believes that the Commission should take steps to require or incentivize improvement in consolidated market data speed and depth without sacrificing the improvements made regarding the speed and depth of direct market data.

B. General Comments

In its Report, the Committee expresses support for certain current initiatives of the regulators, and recommends enhancing other initiatives currently proposed or being considered by the regulators. In previous comments on these topics, SIFMA expressed general support for these efforts and, in some cases, provided additional guidance as to how to further improve the regulatory proposals. More specifically:

- Single Stock Pauses.[21] Like the Committee, SIFMA agreed with the Commission on the need to implement single stock pauses/circuit breakers for the Russell 1000 stocks and actively traded ETFs. Also like the Committee, SIFMA believes that the protections afforded by the pauses should now be extended to all securities. Moreover, SIFMA recommends that the SEC should continue to work with industry participants to explore how circuit breaker trading pauses should be treated across related markets, including the options and futures markets.[22]

- Limit Up/Limit Down.[23] SIFMA supports the implementation of a limit up/limit down approach, and has provided detailed comments as to how such an approach might be implemented.[24] SIFMA agrees with the Committee's suggestion that the Commissions clarify whether securities options exchanges and single stock futures exchanges should continue to trade during any equity limit up/limit down periods.

- Clearly Erroneous Rules.[25] SIFMA supports the SEC's efforts to curtail the markets' discretion in breaking erroneous trades through the SROs' adoption of new clearly erroneous trading rules.[26] We urge the SEC, the exchanges and FINRA, however, to continue to work to ensure uniformity and consistency in the application of these clearly erroneous rules. In addition, we believe that the options exchanges should handle erroneous trades in a manner consistent with the equity markets. We note, however, that if the limit up/limit down approach is adopted, erroneous trades should not occur outside the relevant trading band, thus making the clearly erroneous rules less critical.

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[21] *See* Recommendations 1(a) and 2, Report at 3-4.

[22] SIFMA Comment Letter on Market Structure Roundtable at 2.

[23] Recommendation 3, Report at 5.

[24] SIFMA Comment Letter on Market Structure Roundtable at 3; Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: SIFMA Proposal to Prevent Price Swings Due to Liquidity Gaps (Oct. 12, 2010) (available at http://www.sec.gov/comments/265-26/265-26-42.pdf).

[25] Recommendation 1(b), Report at 3.

[26] SIFMA Comment Letter on Market Structure Roundtable at 5; Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: Clearly Erroneous Executions (July 26, 2010) (available at http://www.sec.gov/comments/sr-bats-2010-016/bats2010016-8.pdf).

- Stub Quotes. [27] SIFMA commends the SEC for its recent efforts to have the exchanges implement minimum quoting requirements for market makers that effectively eliminate their ability to employ stub quotes.[28]

- System-Wide Circuit Breakers.[29] SIFMA agrees with the Committee regarding the need to update the system-wide circuit breakers to work more appropriately in today's trading environment.[30] In this regard, SIFMA believes that any modifications to such circuit breakers should be coordinated between the securities and futures markets.[31]

- Naked Access.[32] As the SEC considered its "naked access" rulemaking, SIFMA expressed support for the principles of pre- and post-trade controls and procedures in sponsored access arrangements.[33]

- Consolidated Audit Trail.[34] SIFMA fully supports the SEC's objective of providing timely access to a robust, cross-market audit trail for NMS securities and ultimately other securities. We continue to question, however, the need for real-time reporting of the entire set of data elements in the SEC's consolidated audit trail proposal, and believe that reporting on a T+1 (or, in some cases, later) basis should satisfy the SEC's stated regulatory objectives more efficiently and be consistent with an appropriate cost-benefit analysis.[35]

- Coordination of Securities and Futures Markets. The Committee makes two recommendations specifically related to the CFTC's oversight of the futures markets – Recommendation 4 regarding a second tier of pre-trade risk safeguards and Recommendation 7 regarding disruptive trading practices. In considering these proposals, SIFMA urges the CFTC to coordinate with the SEC to ensure consistent

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[27] Recommendation 1(c), Report at 4.

[28] SIFMA Comment Letter on Market Structure Roundtable at 4.

[29] Recommendation 5, Report at 6.

[30] For example, instead of the current approach to system-wide circuit breakers, the Commissions could evaluate whether the system-wide circuit breakers should be triggered when a certain percentage of individual stocks are subject to a trading pause.

[31] SIFMA Comment Letter on Market Structure Roundtable at 4.

[32] Recommendation 6, Report at 7.

[33] Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: Management Controls for Brokers or Dealers with Market Access (April 16, 2010) (available at http://www.sec.gov/comments/s7-03-10/s70310-56.pdf).

[34] Recommendation 14, Report at 14.

[35] Letter from James T. McHale, SEC, to Elizabeth M. Murphy, SEC re: Consolidated Audit Trail (Aug. 17, 2010) (available at http://www.sec.gov/comments/s7-11-10/s71110-63.pdf); SIFMA Comment Letter on Market Structure Roundtable at 11.

treatment of the equities and futures markets, and to work with industry participants to ensure the implementation of an efficient and effective approach.[36]

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SIFMA appreciates the opportunity to comment on the issues raised in the Committee's Report. SIFMA notes, however, that the Report does not discuss a variety of other important issues that SIFMA has discussed in recent comment letters, such as issues raised by co-location, access fees, market data quality and market center obligations.[37] We look forward to further discussions about the specific regulatory initiatives raised in the Report and otherwise with the Commissions and their staffs. If you have any comments or questions, please do not hesitate to contact me at 202-962-7300 or avlcek@sifma.org.

Sincerely,

Ann L. Vlcek
Managing Director and
Associate General Counsel
SIFMA

cc: Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
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Robert W. Cook, Director, Division of Trading and Markets
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[36] Robert Pickel, ISDA and Kenneth Bentsen, Jr., SIFMA, to David A. Stawick, CFTC re: Antidisruptive Practices (Jan. 3, 2011) (available at http://www.sifma.org/issues/item.aspx?id=22840).

[37] *See, e.g.,* SIFMA Comment Letter on Market Structure Roundtable and SIFMA Comment Letter on Concept Release.