October 23, 2015

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington DC

Re: SEC Equity Market Structure Advisory Committee, File No. 265-29

Dear Mr. Fields:

Thank you for the chance to comment on the Equity Market Structure Advisory Committee ("Advisory Committee"). My comments are mostly intended for the October 27 agenda item "Discussion of Recent Market Volatility," which, though not noted in the agenda, I suppose refers to the August 24 flash crash, our second market-wide flash crash of $1 trillion or more since 2010.

Circuses

Never a gang to let a genuine crisis go to waste in advancing their interests, lobbyists for the high frequency trading industry are pounding the table that what we need to prevent these events is another deregulatory circus. As an answer to this crisis, these HFT lobbyists suggest, we need to allow firms to aggressively sell short at or through the bid, that certain segments of the industry should be exempt from any Reg SHO prohibitions that kick in during severe market disruptions.[1] The idea even made its way into a Commissioner's recent public statement.[2]

Reg SHO prohibits aggressive short sales in a stock whenever its price falls by a certain percentage. HFT lobbyists want to exempt ETF arbitrageurs from that prohibition so they can hedge whatever long positions they might have in an ETF with short positions in that ETF's constituents. All this would be in the (wholly unsubstantiated) hope these ETF arbitrageurs will continue to align ETF prices with their underlying asset values during a market break. These lobbyists are happy to limit the exemption privilege to "bona fide" ETF arbitrageurs, whatever that means, and if the privilege were enacted I suppose the industry would be as successful in gaming the category as it's been in gaming categories like "bona fide market maker" and "bona fide order."

Anyone of a certain age and experience remembers when lots of HFT firms woke up one day delighted to announce they were "bona fide market makers." That overnight transformation happened immediately after the SEC exempted bona fide market makers from its 2008 emergency orders prohibiting short sales in certain stocks. After all, exchanges didn't ask much more of their market makers than to post stub quotes at

---

[1] See letter dated September 24, 2015 from the Modern Markets Initiative to the SEC, proposing that firms engaged in "bona fide ETF arbitrage activity" should be exempted from Reg SHO restrictions.
[2] "How Can the Markets Best Adapt to the Rapid Growth of ETFs," Commissioner Luis A. Aguilar, Oct. 15, 2015.

a penny, so it was easy enough to be a bona fide market maker at the time, and the privileges handed out to market makers were enormous. No doubt nearly every HFT firm will suddenly realize it's an ETF arbitrageur if the SEC ever exempts them from Rule 201.

There are many answers to the ETF problems we had on August 24. Giving a lobbyist's patrons and their brothers-in-arms the privilege to aggressively sell short our greatest companies when those companies are at their most vulnerable should not be one of them. Imagine what that would do in circumstances like those on August 24 or May 6, 2010. Order books are already thin, ETF pricing is already under stress, and any number of great companies have already suffered severe price dislocations. ETF arbitrageurs - no one knows precisely who they might be, there are few if any standards to call yourself one, and presumably you can hop into the category as easily as buying a share of SPY or IWM - are free to sell short through whatever bids remain in the book. And that creates a feedback loop as aggressive short sales exacerbate stock price declines, price declines further stress ETF prices, and then these stresses lead to more aggressive short sales.

How would that have played out on August 24? According to The Wall Street Journal, Doug Cifu, CEO of the HFT firm Virtu, reported that Virtu "was on track to have one of its biggest and most profitable days in history"; other HFT firms had the like good manners to report the same. Imagine what they could all do with a few more privileges.

Advisory Committee

Whatever their interests or conflicts, the New York Stock Exchange and Nasdaq have a legitimate beef about the Advisory Committee's composition.[3] It's bizarre the Advisory Committee will take up questions like the regulatory structure of trading centers, including the SRO status of the exchanges, without a permanent representative from either of the two major listing exchanges.

And while the listing exchanges are denied a seat on the Advisory Committee, it's also bizarre a person paid millions over the years to preside over ITG, a company which recently admitted to wrongdoing the SEC said was "a course of business that operated as a fraud," still has a seat. With Chair White's apparent indifference over this, it's hard to think of a better illustration of Michael Lewis's point when he said the market is rigged.

Sincerely,

R. T. Leuchtkafer

---

[3] "Exchanges, Schwab criticize SEC market structure committee," Michael Erman, Reuters, October 20, 2015