Peter J. Driscoll
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Elizabeth M. Murphy
Secretary
Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549

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File No. 4-631, Joint Industry Plan to Address Extraordinary Market Volatility

Madam Secretary,

Thank you for the opportunity to comment on the Joint Industry Plan to Address Extraordinary Market Volatility. I have been an active investment professional for over 30 years, working in many different aspects of trading, from floor trader to buy-side trader, participating on numerous industry committees and organizations and have delivered testimony on market structure issues to The United States Senate Banking Committee Sub-Committee on Securities, Insurance and Investment and a Securities and Exchange Commission roundtable.

The current proposal to address extraordinary market volatility is potentially a step in the right direction. However, I am concerned that this proposal is merely treating the symptoms and not the illness. Market structure changes in the early years of this century that reduced minimum price variations for trading and the promulgation of rules that fragmented trading interests (among other changes) are responsible for the current market volatility. These changes reduced the economic feasibility of liquidity providers. Reg. NMS has failed to develop the deep pools of liquidity that were envisioned during its debate and many market participants do not recognize that in order to stem volatility realistic economic rewards for liquidity providers must be restored. It concerns me that much of the effort that we expend on re-regulating the markets tends to treat the symptoms and fails to address the need to develop deep pools of liquidity. I also have some concerns about the current proposal, how the limits will work, how the plan will be administrated, who is responsible for certain aspects of the plan and how the plan was developed.

Circumventing the Formal Notice and Comment Process

While I understand the SEC has concerns that too many cooks in the kitchen can be problematic, I believe that the SEC's use of confidentiality agreements amongst the participants developing this proposal has negative implications for the transparency of the rule making process and sets a dangerous precedent. Delivering a major regulation for comment that was developed via a year long discussion amongst a very limited group of market participants actually stifles the input of others during a comment period as the participants not involved in the original discussions feel that the offered proposed rule is a fait accompli. While this approach may technically meet the requirements of the Administrative Procedures Act it certainly does not adhere to the acts spirit. I strongly believe that good rule making requires the robust dialog and participation of many different constituencies to help uncover the unintended consequences of the proposals. That clearly didn't happen here. Some potentially fatal flaws were overlooked because of the lack of diverse input. The narrow focus of the group that developed this regulation may have also allowed some opportunities to increase competition between exchanges to be overlooked.

Increased Consolidated Quote Latency

The Security Information Processors (SIPs) were granted exclusive rights to process and consolidate the quotes and trades provided to them by their specific plans trading venues. The SIPs which are owned and operated by the exchanges are an industry utility in the purest form, receiving the raw data from the industry, processing and consolidating that data and selling it to the broker dealers who provided the raw material and are required by rules to purchase the final product. The exchanges also compete with the SIPs by selling proprietary, unconsolidated market data products. This conflict of interests could prove troublesome in the current proposal. The exchanges are all for profit entities now and market data sales account for nearly one quarter of their revenue. The SIPs exchange sponsors have a vested interest in ensuring that the SIP doesn't become too efficient, as the more efficient the SIP becomes, the faster their consolidated quotes are delivered to the investing public. The faster the consolidated feed is delivered, the less valuable the exchanges proprietary data feeds become. If the SIP is to perform the new responsibilities (additional calculations) this proposal requires it will necessarily slow the consolidated feeds even more. This would make the consolidated data feeds more latent and would increase the value of the faster proprietary feeds. The Limit up Limit down (LUP) proposal raises significant questions regarding latency arbitrage. The degree of these additional delays are unimportant, the fact that they exist will provide some participants an avenue for nefarious activity.

This latency arbitrage issue is a fatal flaw in the LUP proposal. Until we can find a way to reduce the costs to investors of latency arbitrage, prevent the gaming of non-executable quotes and limit state conditions, the LUP plan is not workable. Would it make sense for the reference price and band calculations to be performed by the trading venues prior to the trading venues sending any data to the consolidator or clients? This would lead to slight differences in the reference prices and thus the limit bands but it would remove the incremental delay between the consolidated and proprietary data feeds.

The Magnet Effect with Hindsight

It is possible that pattern recognition strategies will be developed to push issues that are close to the limit bands through those bands if market participants develop ways to profit from doing so. This is the magnet effect that was discussed, and dismissed by many, during the promulgation of the new Reg SHO Rule 201 circuit breakers, prior to the advent of latency arbitrage. The magnet effect appears to occur much more frequently than many suggested in the Reg SHO discussion as the new trading curbs are being triggered much more frequently than was anticipated. Whether the higher than anticipated election of Reg SHO circuit breaker restrictions is the result bifurcated data feed stream speeds, pattern recognition strategies, less than robust forecasting or some combination of these has not been determined, but the causes do deserve study. In the meantime installing trading bands at half the threshold of the Reg SHO election levels will provide those who have the technological savvy and pecuniary desire to easily manipulate the limit up limit down regime to their advantage. While I understand that this type of market manipulation would be prohibited by other SEC rules, I have seen no evidence that the SEC possess the tools necessary to identify such activity.

Opportunity Lost

Where a stock is listed has absolutely nothing to do with how or where that issue trades. I believe that we are missing an opportunity to enhance exchange competition by awarding listing exchanges the five to ten minute exclusive window to reopen an issue. Five to ten minutes is an eternity in today's markets and exchanges would compete significantly for these reopening rights. Reopening rights could be awarded to the trading venue that has developed the most robust liquidity pool in a specific issue. Periodical reviews of the issues trading volumes could be performed and the reopening rights awarded to the trading venue with the most average daily volume over the review period.

Codifying Advantages for the most Technologically Savey

While I understand that many believe that the optics of limit state trading pauses may diminish investor confidence, I believe that publically displaying quotes that are the results of an altered price discovery process will have greater negative implications for investor confidence. Distribution of altered or non-accessible quotations will undermine the integrity of the market data investors rely upon. When an investor can no longer trust the market data that they receive their confidence in the overall fairness of the markets will surely be shaken to its foundation. Do we really want to indicate that an issue is open for trading when in fact the only trades that can be executed would be at prices that do not represent the true equilibrium of supply and demand? In the name of transparency wouldn't it be better to just stop trading the issue?

The notion that market participants will flock in to provide the additional liquidity needed to move a stock out of the limit condition in fifteen seconds does not appear to have been fully vetted. Many market participants, including buy-side traders who have the necessary liquidity in hand, will not be able to react quickly enough to provide the additional liquidity in the prescribed timeframe. This extremely short non-executable quote condition period would allow only the fastest of trading participants to participate providing them another advantage over more traditional participants. All market participants should be allowed to participate in the re-pricing process. This would yield a price reflecting true supply and demand conditions and better instill investor confidence.

Liquidity providers will behave in their economic best interests. History has shown that in times of uncertainty these participants will flatten their positions and widen their quotes. The Findings Regarding the Market Events of May 6, 2010 states:

> *"Based on their respective individual risk assessments, some market makers and other liquidity providers widened their quote spreads, others reduced offered liquidity, and a significant number withdrew completely from the markets."*

Why would we believe that this behavior would change in any meaningful way under the limit up limit down rules?

One Dimensional Proposal

The proposal set forth addresses equity and equity options markets only. There are many other ways to achieve or unwind the same economic exposure that vanilla equity exposure provides. Most market participants have the ability to trade futures and in other markets around the world. Many equity issues in the US markets have equivalent securities listed in several different foreign jurisdictions. The current proposal has no provisions that would co-ordinate these trading halts across markets in the US or across foreign jurisdictions, yet the above referenced report expressly describes this issue:

"May 6 was also an important reminder of the inter-connectedness of our derivatives and securities markets, particularly with respect to index products. The nature of the cross-market trading activity described above was confirmed by extensive interviews with market participants (discussed more fully herein), many of whom are active in both the futures and cash markets in the ordinary course, particularly with respect to "price discovery" products such as the E-Mini and SPY. Indeed, the Committee was formed prior to May 6 in recognition of the continuing convergence between the securities and derivatives markets, and the need for a harmonized regulatory approach that takes into account cross-market issues. Among other potential areas to address in this regard, the staffs of the CFTC and SEC are working together with the markets to consider recalibrating the existing market-wide circuit breakers – none of which were triggered on May 6 – that apply across all equity trading venues and the futures markets."

Also absent from the current proposal is any effective co-ordination between other existing regulations that attempt to suppress volatility. Clearly erroneous rules designed to prevent orders from fueling volatility should have their election levels re-engineered and co-ordinated with the limit up limit down bands. With the limit bands in place there should be no reason that any trade outside the limit bands should be allowed to stand. The Limit up Limit down proposal should include provisions to this effect and the current clearly erroneous rules should be retired.

More Robust Operating Committee

Why should the plan operating committee only have representatives from the trading venues? This plan will affect every trading participant in the market place. The operating committee should have a diverse representation of all key trading groups, retail order execution representation, institutional buy-side representation and representation of those who focus on small capitalization securities as well as the trading venue representatives.

While I believe the plan to be an improvement to the circuit breaker regime currently in place, I certainly do not believe this plan is anywhere near an implementable proposal. I believe that all the recent proposals designed to dampen volatility are merely treating the symptoms and not the problem, we need to focus on measures that will encourage the provision of liquidity into the price discovery process and that means making it economically profitable to provide that liquidity to the process or less profitable to withhold said liquidity from the price discovery process.

Respectfully Submitted,

Pete J. Driscoll

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