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Corporate America's Leading Issuer Advocate and Market Expert

VIA EMAIL September 23, 2012
(Resubmitted)

Ms. Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Request for Comment for File No 4-562 / Market and Technology Roundtable.

Dear Ms. Murphy:

In response to the aforementioned Request for Comment, we are resubmitting our prior Comment Letter which related to your Release No. 34-67556; File No. SR-NYSE-2012-31; Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Amending NYSE Rule 80C regarding File 4-652 the NYSE's Proposed Rule Change amending NYSE Rule 80C which provides for trading pauses in individual securities due to extraordinary market volatility and which proposal seeks to extend the effective date of the pilot.

Please note that we completely concurred with your decision to extend the pilot to February 4, 2013 but would like to emphasize the need for additional considerations as part of the pilot in light of current developments that have taken place since the inception of the pilot and, in particular, the second quarter of 2012. The aggregate impact of these events has resulted in further erosion of investor confidence in our markets. The recommendations that we set forth in our prior letter and have repeated herein should receive serious consideration at your October 2 Forum.

Your records will indicate that we wrote to you in the ***Spring of 2009*** regarding the need to move from market wide circuit breakers to individual stock circuit breakers. We made that recommendation in direct response to the absurd trading that took place in Dendreon (Nasdaq: DNDN) which saw the company lose over a billion dollars of its market cap in less than a minute with no trading

halt, only to substantially rebound moments later. While we did not know at that time precisely when and where the next crisis might occur, you will recall that we stated that it was just a matter of time before something really big and really bad was going to happen. As it turned out the meltdown that occurred via the Flash Crash was much bigger and far worse than any of us ever anticipated.

*Fast forward to **May 6, 2010*** - The Flash Crash. We have no doubt that had our Spring of 2009 recommendation to move to individual stock circuit breakers been implemented, the Flash Crash would never have happened. Your subsequent and totally appropriate response to adopt single stock circuit breakers following the Flash Crash confirmed our thesis.

*Fast forward once again, this time to the **second quarter, 2012**.* Suffice it to say that several incidents over this period clearly validated our fears that something really big and really bad was imminent. Those events include:

- BATS: While it is very clear that the recent BATS IPO was an embarrassing display by a major market participant in its own transaction, it is likely that properly constructed LULD safeguards would have caused the bogus quotes to have been rejected by the system.
- Splunk: A fat fingered quote in the debut of Splunk on Nasdaq on April 19, 2012 triggered a five minute trading halt just moments after the company launched its IPO. The eyes of the investing world were watching as, yet again, a "crazy quote" tilted the trading in the early moments of an IPO. To add insult to injury, the NYSE's Arca system did not properly trigger the halt on their market. This resulted in broken trades in tens of thousands of shares.
- Facebook: The events surrounding this IPO have been well chronicled and are currently under review. We will not prejudge the results of this post mortem. To be clear, however, Nasdaq's embarrassing performance on this IPO speaks volumes about the need for "what if" risk management tools across all markets and all points of sale.
- Knight: While the disaster at Knight technically took place in the third quarter, the magnitude of the loss was so stunning that we elected to include it in the above list. The confirmed losses incurred in this single event, which took place over a forty five minute period, exceed many times over the contentious losses sustained in the above three events combined.

There is no easy way to describe this series of miscues other than to call it what it is: a **"Circus"**. It has been one foul-up after another.

We have no doubt that the SEC has among its highest priorities the diagnosis of "the circus" events and the appropriate structural adjustments that will lead to much needed safeguards. To this end, we would like to share with you some additional observations and recommendations as supported by the issuer community with whom we have discussed these issues.

<u>Additional Observations:</u>

- We would like to point out our admiration for the manner in which both Knight and the SEC handled the Knight trading matter. As painful as it had to have been, the Knight CEO made certain to take full responsibility for the losses. The complete $440 million loss was borne by the Knight shareholders. No disputes, no bailouts, no belly-aching. The SEC was equally as steadfast in ensuring that investors were protected. This is a text book case in how to properly handle a market calamity. Bravo!
- Many have argued for the return to more human based trading. This notion is, at best, naïve and is no more likely than returning to the horse and buggy. It's just not going to happen. The issue here is not technology. The machines have done exactly what the humans have directed them to do. The issue is putting the proper level of risk management and controls around the technology.

<u>Needs/Recommendations:</u>

- <u>The need for "surge protectors" (volume based protection)</u>. We all missed this one. While the individual stock circuit breakers offer protection against irrational <u>price</u> movement, there is no protection against irrational "<u>volume</u> surges" that do not trigger the circuit breakers. Surely this was the case with Knight as the precision of their algo's did not trip the circuit breakers and still allowed for irrational trading volumes to proceed.
- <u>The need for centralized risk management tools that parallel the technological innovations in the industry</u>. The common denominator in all four incidents in "the circus" is that new programs that worked fine in test mode failed miserably when released to the production mode. The answer is not necessarily more testing. Rather, these events prove that some form of "what if" risk management controls are needed in real time (production mode). This requires greater coordination at both the point of sale (exchange) and the broker/dealer levels. Specifically, we propose two items:
    - <u>A real time kill switch</u>. As early as 9:40 am Bob Pisani on CNBC was reporting great unrest on the NYSE floor due to highly unusual volumes. Still, it took quite a bit longer to contact Knight, identify the problem, etc. and shut it down. Simple fact: technological advances

have resulted in speeds/volumes so great that conventional techniques for halting trading are obsolete. Ideally, a centralized risk manager at either the exchange and/or the broker dealer level should have been in a position to immediately kill all unfilled Knight orders. The kill switch needs to be uniform across all exchanges and market platforms to ensure that there is no ambiguity.

  - Improved analytical tools in production mode. Clearly we need to stop learning by entering fully tested applications into non-parallel production environments only to have them blow up. Scenario based "what if" techniques need to be added to the production mode.

- The need for greater issuer participation in market structure related matters. There is growing frustration in the issuer community that their priorities consistently take a back seat to those of the trading community in terms of market structure. The consensus of issuers is that the trading in their respective stocks has become commoditized and that the equity markets operate more like a casino than a mechanism for capital formation. Make no mistake about it: while issuers embrace technology and the potential liquidity that it represents, they take great umbrage at a market structure that enables opportunists to submit high speed bets on their stock. They seek investors who are looking for a reasonable return on their investment.

We would like to thank the Commission for the opportunity to comment on these critically important items and are hopeful that our observations will find their way into your roundtable discussion on October 2, 2012.

Kindest regards,

PJH

Patrick Healy is CEO of Issuer Advisory Group, Corporate America's Leading Issuer Advocate and Market Expert. Mr. Healy serves on the Board of Directors of Direct Edge (the country's fourth largest stock exchange, which trades but does not list stocks). He holds a CPA and an M.B.A. and spent eight years on the faculty of the Georgetown University McDonough School of Business. Most recently he served as a guest lecturer at the MBA program for the College of William and Mary.