12/22/2004

U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549
Via Electronic Mail

Attention: Mr. Jonathon Katz, Secretary

Re: <u>File No. 34-50870 Re-Proposed Regulation NMS</u>

NexTrade Holdings, Inc., welcomes the opportunity to provide the Securities and Exchange Commission (the "Commission") with its comments to the above referenced filing. The filing enumerated above describes the plans of the Commission to adopt "new substantive rules that are designed to modernize and strengthen the regulatory structure of the U.S. equity markets."[1]

This proposal offers the following initiatives:

(1) The Commission proposes a "Trade-Through Rule" that would "require trading centers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution of trades at prices inferior to protected quotations displayed by other trading centers, subject to an applicable exception….".[2]

(2) The Commission proposes an "Access Rule" that would "require fair and non-discriminatory access to quotations, establish a limit on access fees to harmonize the pricing of quotations across different trading centers, and require each national securities exchange and national securities association to adopt and enforce rules that prohibit their members from engaging in a pattern or practice of displaying quotations that lock or cross automated quotations".[3]

(3) The Commission proposes a "Sub-Penny Rule" that would "prohibit market participants from accepting, ranking, or displaying orders, quotations, or indications of interest in a pricing increment smaller than a penny…".[4]

(4) The Commission is re-proposing amendments to the "Market Data Rules" that would "update the requirements for consolidating, distributing, and displaying market information,

[1] Securities and Exchange Commission 17 CFR PARTS 200,201, 230, 240, 242, 249 and 270 [Release No.34-50870; File No. s7-10-04] p. 1, 2.
[2] *Id.* p. 4.
[3] *Id.* p. 4.
[4] *Id.* p. 4.

as well as amendments to the joint industry plans for disseminating market information that would modify the formulas for allocating plan revenues ("Allocation Amendment") and broaden participation in plan governance ("Governance Amendment")."[5]

The Trade-Through Rule

On April 14, 2003 NexTrade submitted a petition for rulemaking to the Commission requesting the Commission to promulgate a rule to extend trade-through protection from the market for Listed securities to the entire market, with consideration for speed discrepancies generally found between electronic and manual markets. Specifically, we stated, "NexTrade has crafted a proposed rule to prevent trade-throughs and locked or crossed markets similar to the existing rules of the Listed market. However, NexTrade's proposed rule has been modernized to eliminate the problems associated with the Listed version of the Trade-Through Rules, mainly, the disparity of processing speed between market centers."[6]

When originally proposed in the first Regulation NMS release, the Commission sought to bifurcate trading centers into "fast" and "slow" markets.[7] Additionally, the original release proposed an "opt-out" provision to the Trade-Through Rule under certain circumstances. As addressed in this release, industry comment was sharply divided on the need for an extended Trade-Through Rule, on the specifics of definitions for "fast" or "slow" markets, and on the appropriateness and regulatory viability of an "opt-out" provision.

In NexTrade's opinion, the Commission expertly integrated industry comment and the re-proposal has artfully re-categorized the bifurcation into "automatic" and "manual" markets. Further, the proposed definitions for "automatic" and "manual" markets are clear with concise requirements that industry participants can easily use to measure, assess, and plan. NexTrade applauds the Commission for its progress to a resolution of this divisive and dramatic issue.

Unfortunately, the Commission has also requested comment on including a depth of book ("DOB") protection for the Trade-Through Rule. On its surface, protection of the depth of book is a good idea. However, as the Commission is also proposing a 1 second flicker exemption from trade-through protection, further clarification should be given regarding the applicability of the flicker exemption to the DOB. Specifically, the Commission stated, "[T]o address the problem of flickering quotations, re-proposed Rule 611(b)(8) sets forth an exception that allows trading centers a one-second 'window' prior to a transaction for trading centers to evaluate the quotations at another trading center. Trading centers would be entitled to trade at any price equal to or better than the least aggressive best bid or best offer, as applicable, displayed by the other trading center during that one-second window."[8]

[5] Securities and Exchange Commission 17 CFR PARTS 200,201, 230, 240, 242, 249 and 270 [Release No. 34-50870; File No. s7-10-04] p. 1, 2.
[6] *See* letter from NexTrade to the Commission, April 14, 2003.
[7] The Commission originally proposed Regulation NMS in February 2004. Securities Exchange Act Release No. 49325 (Feb. 26, 2004), 69 FR 11126 (Mar. 9, 2004) ("Proposing Release"). It issued a supplemental request for comment in May 2004. Securities Exchange Act Release No. 49749 (May 20, 2004), 69 FR 30142 (May 26,2004) ("Supplemental Release").
[8] *See* SEC Release No.34-50870; File No. s7-10-04] *Supra* note 1 p 51, 52.

If the flicker exemption is applied to the DOB, then this proposal may open the field to a new degree of market display gaming. Market Centers may have incentive to flicker their quotes within five or ten cents of the current market price, particularly if a flickering convention develops. An intentional "Flicker Spread" could result, opening the door to price executions well outside the mean.

In general, displayed retail orders should mitigate the risk of such abuse. Nevertheless, it seems possible that with a trade-through extension to the DOB, a "Flicker Spread" could develop on issues with high volume and high transitory volatility, particularly during peak-load events such as the open, close, and news releases. Taken in conjunction with the re-proposed Market Data Revenue Distribution Formula ("MDF"), which rewards quotes at the inside, the "Flicker Spread" could become a serious problem. Finally, the Commission must recognize that the practicability of enforcement for a 1 second window across multiple price tiers over lines that may be geographically distant, Hawaii to New York for example, is a profound logistic challenge.

Conversely, if the flicker exemption is not applied to the DOB, but there exists an alleged protection of displayed DOB quotes, then the Commission's concern that flicker traffic can create the "impression" of trade-throughs may be geometrically exacerbated by this re-proposed rule.[9] The DOB protection will significantly impact the trading patterns of institutions and hedge funds. Potentially, it will force the reserve functions for block trades deeper into hiding, creating "underground liquidity" rather than improving display as the Commission seeks. This is a serious and meritorious topic, deserving the industry's full attention and debate, not a 30-day comment period.

In seeking comment on the DOB protection, NexTrade fears the Commission has opened the door for an extended comment period on another potentially divisive issue. Rather than delivering a belated, comprehensive yet untried solution to the market, NexTrade would recommend that the Commission pass the Trade-Through Rule without the DOB protection. The Trade-Through Rule for just top of book is sufficient to set the industry on its collective ear for the foreseeable future, compounding the change with the DOB protection, which, for the record, NexTrade ultimately favors as a good idea, could result in too dramatic a change for the industry to absorb in a stable fashion.

The Access Rule

According to the Commission, proposed Rule 610 is designed to promote access to quotations in three ways:

(1) It would enable the use of private linkages offered by a variety of connectivity providers, rather than mandating a collective linkage facility such as ITS, to facilitate the necessary access to quotations."[10]

[9] *Id.* p. 51.
[10] *Id.* p. 17.

(2) It would limit the fees that any trading center can charge (or allow to be charged) for accessing its protected quotations to no more than $0.003 per share."[11]

(3) It would require SROs to establish and enforce rules that, among other things, prohibit their members from engaging in a pattern or practice of displaying quotations that lock or cross the automated quotations of other trading centers. <u>Trading centers would be allowed, however, to display automated quotations that lock or cross the manual quotations of other trading centers</u>. (<u>emphasis added</u>)"[12]

NexTrade agrees with the Commission that enabling the use of private linkages does promote access, provided that the private linkages are not the sole means of communication between Trading Facilities and between Trading Centers. Anyone with exposure to ITS recognizes that its archaic technology and restrictive membership provisions actively limit access. The Commission is correct in asserting that expanding the means through which access is possible inherently expands total access, however, it does not necessarily follow that private linkages inherently expand access. In fact, NexTrade contends that private linkages, when used to replace existing and universal industry links, reduce <u>total</u> access, which is contrary to the Congressional mandates for the Commission.

In past letters to the Commission, NexTrade has repeatedly submitted that the Commission has done no research to validate the idea that private sector solutions are sufficient for the industry to satisfy its obligations under the Act.[13] Rather, the Commission merely "believes" this to be the case. Many in New York and Boston also "believed" in the "Curse of the Bambino"; belief is not enough. It truly is a bad idea.

The Commission has mentioned the problem, but has not attempted to reconcile the fact that forcing a firm to support connectivity costs beyond its means to participate in an OTC venue cannot be "<u>**ENTIRELY VOLUNTARY,**</u>"[14] which was the condition precedent to Supermontage approval. Rather than addressing the fundamental concern that Rule 4300 of ADF cannot work in light of the condition precedent, the Commission sites that the NASD is not "statutorily required to provide an order execution facility in the ADF".[15]

However, the NASD is required to establish rules that do not unfairly discriminate against members. Section 15A(6) of the Act states, "The rules of the association are designed to

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[11] *Id.* p.19.
[12] *Id.* p.19.
[13] *See* NexTrade letter to the Commission dated July 29, 2004. p. 15. *See also* Letter to SEC from Junius W. Peake (Monfort Distinguished Professor of Finance), April 24, 2000. "What is fair competition? Isn't it providing all market participants equal information and access to market facilities at equivalent cost for services?… The system must execute orders quickly, cheaply and accurately…The system must treat all market participants-brokers, market makers, investors and market center operators-equally…. The system must, by its design, allow all bids and offers in the same security to interact with each other to provide the lowest cost for the buyer and the highest sale proceeds for the seller."
[14] *See* SEC Release No. 46429 File No. SR-NASD-99-53 ORDER WITH RESPECT TO THE IMPLEMENTATION OF NASDAQ'S SUPERMONTAGE FACILITY p. 1.
[15] *See* SEC Release No.34-50870; File No. s7-10-04. *Supra* note 1 p. 99.

prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; **and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers**[16], to fix minimum profits, to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members, or to regulate by virtue of any authority conferred by this title matters not related to the purposes of this title or the administration of the association."

The Commission's own release acknowledges its obligation to foster a fair market: "[T]he Commission has preliminarily determined that approximately 600 broker-dealers registered with the Commission, which includes broker-dealers operating as equity ATSs, broker-dealers registered as market makers or specialists in NMS stocks, and any other broker-dealer that is in the business of executing orders internally, would be subject to Rule 610. In addition, the existing operating ATSs (which are or are operated by registered broker-dealers) potentially could be subject to the reproposed amendment to Rule 301 of Regulation ATS. Of these broker-dealers, only two are considered small for purposes of the Regulatory Flexibility Act pursuant to the standards of Rule 0-10(c) under the Exchange Act. Accordingly, the Commission preliminarily does not believe that re-proposed Rule 610 and the re-proposed amendments to Rule 301 of Regulation ATS would have a significant economic impact on a substantial number of small entities."[17] It is clear from the language that the Commission has not concluded that the proposed Access Rule is not discriminatory and therefore lawfully passable. Rather, the Commission recognizes that the rule could result in significant economic impact but the **number** of small firms (2) that may be impacted is so low that it is an acceptable casualty rate.

In light of proposed Rule 610, any display-only SRO creates a cost barrier that **actively** prohibits any small firm from membership. **Such a rule clearly discriminates against smaller firms and is therefore unacceptable under the Act**.

NexTrade has raised the issue of cost as it relates to smaller firms, the NASD has raised the issue of cost as it relates to smaller firms, and many at the hearing raised the issue of cost as it relates to smaller firms.[18] Proposed Rule 610, as written, is unclear with respect to bearing the cost of connectivity. It reads, in pertinent part:

(b) <u>Quotations of SRO display-only facility</u>.

[16] Emphasis added.
[17] *See* SEC Release No.34-50870; File No. s7-10-04. *Supra* note 1, at p. 268.
[18] *Id.* p. 97.

(1) Any trading center that displays quotations in an NMS stock through an SRO display-only facility shall provide a level and cost of access to such quotations that is substantially equivalent to the level and cost of access to quotations displayed by SRO trading facilities in that stock.

Under the current ADF rules, parties connecting to access ADF quotes must split the costs unless otherwise agreed. With respect to when NexTrade connects to the Nasdaq, NexTrade bears the entire burden for connectivity. Rule 610 as written empowers ADF participants to charge fees commensurate with the Nasdaq's for connectivity. However, this interpretation seems to contradict most of the language of the release. NexTrade specifically requests clarification on this matter.

To date, the Commission has also failed to address NexTrade's concern that private sector links are outside of the authority of the SEC. Three of the largest connectivity providers active today are Radianz, Lava, and Brass. As the Commission knows, Radianz is owned by Instinet, a competitor to NexTrade, Lava is owned Citigroup, a competitor to NexTrade, and Brass is owned by Sunguard, a competitor to NexTrade. It is easy for the Commission to state that an "ADF participant would have the option of establishing connections to these industry access providers"[19] but there is absolutely nothing preventing any or all of these firms from denying NexTrade, or any other competitor, access.

If the Commission takes the time to look at most of these "industry access providers" it will find that they are nearly all owned by brokerage firms that compete for business. It stuns NexTrade that the Commission is so concerned about possible conflicts of interest between an SRO's business functions and its' regulatory functions,[20] but that the Commission is willing to turn a blind eye to the same conflict of interest developing in the total market between the business functions of brokerage firms and the critical, regulatory functions of the connectivity firms owned by said brokerage firms.

In the matter of the SROs, at least both the regulatory divisions and the business division of the SROs are under the direct auspices of the Commission. To NexTrade's knowledge, most of the "industry access providers" are not even broker dealers. In fact and by intent, they operate outside the Commission's authority.

The Commission also states that limiting the access fee to $.003 will somehow promote access. To justify this contention, the Commission exerts the following:

(1) the Commission contends that, "[A] single accumulated fee cap would apply equally to all types of trading centers and all types of market participants, thereby promoting the NMS objective of equal regulation of markets and broker-dealers;"[21]

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[19] *Id.* p. 100.
[20] *See* Securities and Exchange Commission 17 CFR Part 240 Release No. 34-50700; File No. s7-40-04 RIN 3235-AJ36 CONCEPT RELEASE CONCERNING SELF-REGULATION p. 7.
[21] *See* SEC Release No.34-50870; File No. s7-10-04. *Supra* note 1 p. 104.

(2) the Commission contends that, "[T]he $0.003 cap would preclude the outlier business model;"[22]

(3) the Commission contends that, "[I]f outlier markets were allowed to charge exorbitant fees and pass most of them through as rebates, the published quotations of such markets would not reliably indicate the true price that is actually available to investors or that would be realized by liquidity providers."[23]

NexTrade asserts that the Commission has it wrong on two counts with respect to the Access Rule. To begin, an ECN cannot look inside its own book and decide, post review, whether or not it should act as Agent or Principal. ECNs always act as a blind Agent, matching orders according to a pre-established, non-discriminatory method. Under the rules as proposed, market makers will be able to charge Access Fees and charge the spread. NexTrade raised this issue with the Commission numerous times over the years but has never received any kind of response to this proposed disparity. For the Commission to say that this proposal promotes "equal regulations" is fallacious.

Moreover, for the Commission to imply that fixing the Access Fee at a set rate will end false price quoting, while it does not prevent sub-penny executions inside markets with penny minimum-price-variant ("MPV") quotes, is incongruous. Under the proposed rules, execution prices, including access fees, could still **vary by more than a penny from the displayed price**.

Furthermore, NexTrade is unaware of any FACTUAL economic evidence that shows the distortion from true price caused by Access Fees is any greater than the distortion caused by Principal trading activity. On the contrary, studies NexTrade has seen indicate that market maker spreads are comprised of minimum tick size, order processing costs, competition, expected inventory-holding premium, and adverse selection risk, all of which can be greater than the Access Fee.[24] NexTrade is aware of economic research that evinces historical adverse selection cost and inventory costs for market makers of approximately $.02 per share, which is more than twice the cost of any access fee and must impact the "true price" to some degree.[25]

Unfortunately, NexTrade must agree with the Commission that it intends to preclude the "outlier" business model, which is specifically designed to attract liquidity through the payment of higher rebates and the assessment of higher Access Fees. What escapes NexTrade is the rationale behind actively extirpating this business model. Unlike the Principal model, there is no spread capture through the outlier model. Since the spread is always potentially larger than any Access Fee, the outlier model may, in fact, have a lower cost distortion than the Principal model.

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[22] *Id.* p. 106.
[23] *Id.* p. 106
[24] *See* "Modeling the bid/ask spread: measuring the inventory-holding premium" Nicolas P,B. Bollen, Tom Smith, Robert E, Whaley, Journal of Financial Economics 72 (2004)97-141
[25] *See* "The components of the bid-ask spread: A general approach" Huang, R.D., Stoll, H.R., 1997 Rev. Financial Studies. 10, 995-1034

Moreover, disenfranchised market makers that could no longer sustain a profit in the Principal business created the vast majority of volume generated by the outlier model. The primary difference of these market-makers' activities were that they held less advantaged a position with respect to shorting and internalization but a more advantaged position with respect to quote flexibility, all which benefited the market. Although never before under the specific term "outlier", NexTrade has asserted before that if the Commission believes market makers and specialists add value to the market, then the Commission should hold a similar view of the "outlier" traders. Should this "outlier" volume no longer exist, it would reduce total market liquidity and increase total market risk. Historically, between the various "outlier" trading centers, more than 15% of total NMS volume was traded on a daily basis at different given times.

NexTrade has submitted numerous research citations to the Commission illustrating the immense economic benefit of ECNs to the market, all for the purpose of validating its position that the "outlier" model is beneficial to the individual investor and in the worst case nor more harmful than the Principal model.[26] NexTrade regrets that the Commission has taken a position against the "outlier" model and seeks an understanding as to the apparent illogic of the Commission's position. From NexTrade's perspective, the "outlier" model increases total market liquidity, which benefits all investors; the "outlier" model has a lower intrinsic cost to the investors in a comparison between the spread and the Access Fee, which at least gives the investor a choice between costs; the "outlier" model is an Agency model, which eliminates any conflict of interest with investors; and, the "outlier" model allows smaller firms to compete in an otherwise narrow field, which allows the Commission to satisfy its mandate to promote competition in the industry. By comparison, the Commission's statements that Access Fees obscure the quote is **<u>false</u>** in a penny MPV quotation, sub-penny execution market, and, the Commission's statement that Access Fees distort true price is unfounded when economic research shows the alternative Principal methods may have intrinsically higher distortion than any possible Access Fee.[27]

Finally, even if the Access Rule is adopted as proposed, it does not contemplate the risks associated with collections for the Access Fees. As stated in previous letters to the Commission, unless something is done to eliminate the collection risk, smaller Trading Centers will have a more difficult time competing.[28] NexTrade intends to petition the Commission to adopt a rule that allows for firms to bill for the Access Fee within the trade, in a fashion similar to the manner in which the Commission collects its own funding.

While NexTrade agrees with the re-proposed locked or crossed language for the Access Rule, NexTrade otherwise disagrees with the remainder of Access Rule as it is re-proposed. NexTrade does not believe it will promote competition, lead to a more perfect market, or act to benefit the investment community and it should not be adopted.

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[26] *See* Letter from NexTrade Holdings, Inc. to the Commission June 9, 2002 p. 23-25.
[27] *See* "The components of the bid-ask spread: A general approach" *Supra* note 25 p.1.
[28] *See* Letter from NexTrade Holdings, Inc. to John Polise, the Commission, and all Commissioners June 2, 2003 p. 2-3.

The Sub-Penny Rule

"Estimates of the benefit to the public from decimalization are grossly overstated"[29]

Lawrence E. Harris
Former Chief Economist and Director of the Office of Economic Analysis, Securities and Exchange Commission

It is clear that the Commission recognizes the danger of an MPV that is too small. In this release, the Commission stated, "if the MPV decreases beyond a certain level the potential costs to investors and the markets might increase and could at some point surpass any potential benefits."[30]

NexTrade agrees with the Commission. In fact, NexTrade believes that the market passed this inflection point when it migrated from a fractionalized pricing convention to a decimalized pricing convention. Relatively speaking, a materiality question rises when the sub-penny pricing contraction of this proposed regulation is compared to the nickel-plus contraction of the decimal conversion. Beyond a relative correlation, though, a materiality question is inherent when dealing with sub-penny pricing and the Commission should assess if the sub-penny rule, as proposed, will do anything measurable to the market before it is passed.

NexTrade asserts that the presence of ECNs in the OTC market have magnified the impact of decimal trading in that market more so than with respect to the listed market. Due to the NYSE's unique position and operating structure, it has been, to date, more able than other exchanges to control its market share and, in turn, has been more successful in maintaining a pricing convention that makes profitable Principal trading less challenging.

NexTrade postulates that while decimals have reduced the spreads in stocks, it has fragmented liquidity, created more "underground liquidity" and in general reduced the quality of trading information inside the market. If the Commission agrees with NexTrade that the OTC market has been more affected by decimals, then the Commission should re-analyze its position for the need of a nickel MPV based on its own statements:

- "Accordingly, the effective spread statistics for marketable limit orders, and particularly for orders in Nasdaq stocks, must be considered in conjunction with the fill rate for such orders – a narrow spread is good, but the benefits are greatly

[29] *See* "The effect of decimalization on the components of the bid-ask spread" Scott Gibson, Rjdeep Singh, Vijay Yerramilli. Journal of Financial Intermediation 12 (20030 121-148 footnote 6,
[30] *See* SEC Release No.34-50870; File No. s7-10-04. *Supra* note 1 p. 122.

limited if investors are unable to obtain an execution at that spread. (emphasis added)"[31]

- "For Nasdaq stocks, the Rule 11Ac1-5 statistics reveal very low fill rates for larger sizes of marketable limit orders (e.g., 2000 shares or more), which generally fall below 50% for most Nasdaq stocks. Contrary to the assertion of some commenters, certainty of execution clearly is not a strength of the current market for Nasdaq stocks."[32]

- "The staff analysis found that transitory volatility is significantly higher for Nasdaq stocks than for NYSE stocks. Excessive transitory volatility indicates a shortage of liquidity. Such volatility may provide benefits in the form of profitable trading opportunities for short-term traders or market makers, but these benefits come at the expense of other investors, who would be buying at artificially high or selling at artificially low prices. Retail investors, in particular, tend to be relatively uninformed concerning short-term price movements and are apt to bear the brunt of the trading costs associated with excessive transitory volatility."[33]

The concerns raised by the Commission in this rule proposal of Nasdaq market quality demonstrates that a constructive outcome of the conversion to a decimal pricing convention is at least in question and corroborates that a higher MPV may be ineluctable; this has not escaped the Commission. The Commission states, "[H]owever, if the SROs in the future believe that an increase in the MPV is necessary or desirable, they may propose rule changes to institute the higher MPV. The Commission would evaluate those proposals under the requirements of the Exchange Act at that time."[34]

NexTrade appreciates that the Commission agrees to keep an open mind on this significant issue, but it appears that the Commission has not rationalized the re-proposal it is currently making in relation to the competitive pressures that initially forced the Commission to propose the Sub-penny ban rather than allowing the SROs to propose such a ban individually. "Outlier" exchanges exist that would not enforce such a ban for the express purpose of capturing the sub-penny market share.

As the Commission knows, the NASD submitted a proposed rule to limit the quoting of Nasdaq stocks to a penny MPV.[35] The Commission recognized, though, that the greater public good would not be served by hoping this rulemaking would overcome competitive realities to magically migrate on an exchange-by-exchange basis and it therefore proposed Rule 612. It follows logically that the conditions that required action from the Commission on a sub-penny MPV remain constant for the possible implementation of a higher MPV.

[31] *Id.* p. 34.
[32] *Id.* p. 35
[33] *Id.* p. 36
[34] *Id.* p. 134
[35] *See* SR-NASD-2003-121, since withdrawn.

Rather than dismissing the issue as a matter for individual exchanges to propose rules they cannot competitively pass without a uniform convention, which as the Commission knows may create grounds for price-collusion actions, NexTrade suggests that the Commission should not pass the sub-penny rule because it is immaterial but instead open a comment period for deliberation over the establishment of a nickel MPV. NexTrade believes that an MPV that allows for profit from Principal activities is crucial to capital formation, which has been remarkably dry since the implementation of decimals.

In assessing the impact of decimal pricing to the market, the Commission cannot focus solely on derived savings to investors from the spread differential. The Commission must look at the total impact, including reduced market value of equities, increased fragmentation, and decreased capital formation activity. The Commission must recognize that firms that would otherwise underwrite public offerings are much less likely to do so now because they cannot profitably support the aftermarket. In removing the profit from the spread, decimals have removed an entire layer of professional, high leverage traders from the market, thereby reducing liquidity, increasing transitory volatility, increasing risk, and decreasing the value of equities.

A nickel MPV has proven to work in the options market. As the Commission understands, options as derivatives are lower priced than the underlying, which means that a nickel MPV in the option market is a far higher proportional spread. At a minimum, the equities market should have the same MPV. Alternatively, the industry may be receptive to tiered MPVs based on price. NexTrade would suggest a four decimal MPV for stocks under $1.00, a nickel MPV for stocks under $50 and a dime MPV for any price greater than $50.

Market Data Revenue

NexTrade supports the MDF as re-proposed provided that a DOB trade-through protection is not concomitantly promulgated. As referenced earlier, the flicker exemption for the Trade-Through Rule may create opportunities for gaming: a “Flicker Spread”.

The MDF as re-proposed will reward quotes at the inside, which NexTrade advocates. As the Commission notes, by virtue of being at the inside, the opportunities for quote display gaming will be allayed by the risk of execution, but NexTrade does not presume this deterrent to be absolute. Should the Commission extend trade-through protection to the DOB, and reward quotes at the inside, the risk of “Flicker Spread” is exacerbated.

Summary

- NexTrade supports the Trade-Through Rule but does not believe it is appropriate to pass a DOB protection at this time. Change in this industry should be rational and incremental; a simple trade-through rule will have a substantial economic impact on all participants.

- NexTrade does not support the Access Rule. It is unclear on the burden of cost distribution in terms of SRO Display Only Facilities. The Rule as re-proposed does not promote “equal regulation.” The Commission’s positions that Access Fees distort true price are invalid, both on a relative basis to Principal Trading and in regard to actual pricing in a market that permits sub-penny executions but limits quoting to a penny MPV. The Commission has provided no demonstrable evidence that the “outlier” business model that it intends preclude with this Rule should, in fact, be precluded. NexTrade asserts the “outlier” business model adds liquidity that otherwise would not exist and serves the function of the market makers in a more effective manner without an inherent conflict of interest against the individual investor.

- NexTrade does not support the Sub-Penny Rule because it is immaterial. The Commission’s position that it must forward a sub-penny MPV as opposed to individual exchanges, whereas individual exchanges must forward a higher MPV rulemaking on an individual basis as opposed to the Commission, is inconsistent logic. NexTrade asserts the Commission must act to set an MPV otherwise competitive pressure will deconstruct any MPV. The appropriate MPV in the equities market is at least nickel or some reasonable, tiered alternative.

- NexTrade supports the Market Data Formula as re-proposed, provided the DOB protection is not concomitantly promulgated.

Sincerely,

John M. Schaible
President
NexTrade Holdings, Inc.
JMS/j