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Sent: Saturday, June 12, 2010 3:21 PM
To: colocation <colocation@CFTC.gov>
Subject: Co-location/ Proximity Hosting Services

Dear Mr. Secretary,

I would like to submit a comment regarding Co-location and Proximity Hosting Services.

I am a private citizen, who currently is not engaged in the futures markets, but would like to participate in the future. I have a PhD in Economics from UC Berkeley and I have worked in the financial services field before developing high frequency algorithms.

The main economic benefit that I see for using co-location is to utilize the information of price changes coming directly from the exchanges. I believe a major part of this benefit is to just change and price of an order whenever the market price changes. Let me give you an example, if you wanted to buy a security, it would be far cheaper to buy at the bid price than paying the bid-ask spread. However, as soon as the bid price changes, you would need to adjust your price if you want to maintain your probability of execution and not over pay. The same example holds if you would like to sell a security, it would be far better to sell at the ask price.

As the market fluctuates continuously, one would need to adjust their bid and ask continuously. The only people who can do this effectively are those who are co-located next to the exchanges.

We can learn something however from the technologies utilized in the trading of other asset classes. Because there is far more competition in the equity and fx arena, there are advanced order types which allow one to gain most of the advantages of co-location. If the futures exchanges were to allow Pegged Orders along with Icebergs Orders, then the majority of advantages from utilizing co-location would be substantially reduced. Pegged Orders allow an order to move along with the market and adjust automatically with the market. An order can be pegged to the Bid, or Ask, or Mid, allowing efficient execution without resending thousands of cancel orders every time the price changes. Icebergs Orders allow participants to submit an order without revealing the full amount intended to buy or sell. Large displayed orders can sometimes cause a panic in public markets because the sizes are greater than normal volumes. By requiring exchanges to support advanced order types, such as Pegged - Iceberg Orders, this can allow someone with sufficient patience to execute orders in the market discreetly while saving substantially by not paying the bid-ask spread.

As it stands now, when the exchanges do not offer advanced order types, the majority of orders they receive get cancelled and unfilled. These orders get cancelled because the market price changes and fluctuates. The situation guarantees a virtual arms race in technology as the speed of market data increases. People will seek out co-location to react faster to market data, and the exchanges have to spend more money on technology infrastructure to acknowledge

incoming orders, which in all likelihood be canceled. This huge volume of orders provides no economic benefit since the majority are canceled. However, if people are allowed to submit Pegged orders, then only one order needs to be submitted and acknowledged. By allowing Pegs and Icebergs, a virtuous cycle for the exchanges can be created, benefitting everyone. Pegs and Icebergs will allow more people to act as virtual market makers without necessitating the best co-location and computer equipment. As the bid-ask spreads tighten from market maker competition, more people will come into to do market orders who desire the immediacy vs the cost of crossing the bid-ask spread. More sustained volume will support more market makers and the spreads will tighten again leading to more volume. Eventually it will come to some sort of equilibrium.

I appreciate your considerations regarding these comments.

best regards,
A.D. Tsai