

May 5, 2011

Via Agency Website

Mr. David Stawick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Center
1155 21 Street, NW
Washington, DC 20581

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

Re: Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010, Summary Report of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues dated February 18, 2011 (the "Report")

Dear Mr. Stawick and Ms. Murphy:

We welcome the recommendations of the Joint CFTC-SEC Advisory Committee (the "Committee") in response to the market events of May 6, 2011. We appreciate the opportunity to continue to work with regulators and provide comment on these proposals with the goal of improving the resiliency of our markets while preserving the market quality gains made in recent years due to increased competition and automation.

The Report supports many of the steps already taken by regulators and exchanges to implement safeguards aimed at making markets more stable and resilient, including stock-by-stock circuit breakers, improved erroneous trade policies, and the elimination of stub quotes. It also recommends additional safeguards, including additional "limit-up/limit-down" mechanisms and an improved audit trail. These important reforms, taken together, will directly help to reduce uncertainty and thereby allow professional traders and other market participants to provide liquidity and contribute to price discovery while appropriately managing risk. These reforms not only represent an effective response to the events of May 6, but also embody a long-term policy to safeguard the fundamental structure of the markets that has proven to be so beneficial to investors.

We offer our specific comments after a restatement of each of the Report's fourteen recommendations, as follows:

1. *The Committee concurs with the steps the SEC (working with the Exchanges and FINRA) has taken to*
 - a. *Create single stock pauses/circuit breakers for the Russell 1000 stocks and actively traded ETFs,*
 - b. *Enact rules that provide greater certainty as to which trades will be broken when there are multi stock aberrant price movements, and*
 - c. *Implement minimum quoting requirements by primary and supplemental market makers that effectively eliminate the ability of market makers to employ “stub quotes.”*

We agree that the Securities and Exchange Commission (“SEC”), the securities exchanges and the Financial Industry Regulatory Authority (“FINRA”) have taken constructive and appropriate actions that have increased certainty about trade-breaks and reduced the potential for erroneous trades at irrational prices. We urge the SEC and the exchanges to monitor the performance of these safeguards and to continue to refine and calibrate the rules to make sure that limits and thresholds are appropriate to maintain orderly markets without unduly harming market quality during normal periods.

We also urge the Commissions and the exchanges to favor simplicity in their rule-making, as the events of May 6 demonstrated, in part, how complex rule sets (like those related to Reg NMS routing requirements and self-help) can exacerbate uncertainty and inhibit risk management for market participants.

2. *The Committee recommends that the Commissions require that the pause rules of the Exchanges and FINRA be expanded to cover all but the most inactively traded listed equity securities, ETFs, and options and single stock futures on those securities.*

We agree that the goal should be to cover as many securities as practical. However, we note that less liquid securities pose different issues as their bid-ask spreads are often wide and their trading infrequent which may lead to false positives. Dealing with such securities may require a complicated set of rules around circuit breakers or limit up/limit down and this kind of complexity could impose additional costs on the markets. We urge regulators to monitor the expansion of these safeguards and regularly review the triggering parameters to find an appropriate balance.

3. *The Committee recommends that the SEC work with the Exchanges and FINRA to implement a “limit up/limit down” process to supplement the existing Pause rules and that the Commissions clarify whether securities options exchanges and single stock futures exchanges should continue to trade during any equity limit up/down periods.*

We are encouraged by the recent proposal by the securities exchanges and FINRA to establish a new “limit up-limit down” mechanism to address instances of extraordinary market volatility in U.S. equity markets. Limit up/limit down should provide similar benefits to a trading halt,

while minimizing the costs and risks associated with interrupting continuous trading and denying market participants a continuous flow of market data during critical time periods. We therefore agree that limit up/limit down would be a superior approach to the current circuit breaker approach.

4. *The Committee recommends that the CFTC and the relevant derivative exchanges evaluate whether a second tier of pre-trade risk safeguards with longer timeframes should be instituted when the “five second limit” does not attract contra-side liquidity.*

In addition to multiple tiers of stop spike logic functionality, the CME has price banding in conjunction with limit up/limit down functionality, price protection for market orders and it coordinates with equities markets on system-wide circuit breakers. While we agree with the goal of the recommendation, and recognize that safeguards such as these benefit from ongoing monitoring and calibration, it isn't clear that additional safeguards are required.

5. *The Committee recommends that the Commissions evaluate the present system-wide circuit breakers and consider:*
 - i. *reducing, at least, the initial trading halt to a period of time as short as ten minutes*
 - ii. *allowing the halt to be triggered as late as 3:30 pm and*
 - iii. *using the S&P 500 Index as the triggering mechanism.*

We agree that, in light of considerable changes in the market since the system-wide circuit breakers were approved and implemented, we should reevaluate the current model. We believe the recommendations above are a good starting point.

6. *The Committee supports the SEC’s “naked access” rulemaking and urges the SEC to work closely with FINRA and other Exchanges with examination responsibilities to develop effective testing of sponsoring broker-dealer risk management controls and supervisory procedures.*

We support requiring that all trades entering the market – not just those generated by firms engaged in automated trading – have appropriate pre-trade risk checks. The Futures Industry Association and others have produced recommendations regarding best practices for risk controls.¹ We believe that specific risk controls would be most effectively determined by exchanges, through a combination of risk controls on their electronic platforms and requirements on their members. These requirements would then apply equally to all traders, regardless of their regulatory structure.

We urge policy-makers to weigh the impact to competition of any new regulation in this area. New regulatory burdens, such as requirements to become SEC registered broker-dealers and members of numerous exchanges and other trading venues, act as barriers to entry and

¹ http://www.futuresindustry.org/downloads/Trading_Best_Practices.pdf,
http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/tacpresentation030111_ptfs1.pdf

competition in our markets. Such additional barriers might be justified in light of potential risks, but policy-makers should also consider potential impacts on competition.

7. *The Committee recommends that the CFTC use its rulemaking authority to impose strict supervisory requirements on DCMs or FCMs that employ or sponsor firms implementing algorithmic order routing strategies and that the CFTC and the SEC carefully review the benefits and costs of directly restricting “disruptive trading activities” with respect to extremely large orders or strategies.*

While we support appropriate pre-trade risk controls as described above, it is important not to impose solutions from the securities markets on other markets without taking into account the significant differences in market structure. Unlike equity markets in which a firm must be a broker-dealer to become an exchange member, in futures markets, firms are not required to be FCMs in order to become exchange members. As a result, most futures exchange members are not FCMs. Accordingly, the markets have developed pre-trade risk solutions that share responsibilities for pre-trade risk between exchange members, clearing firms and exchanges. Among other things, the futures exchanges, in conjunction with FCMs, have extensive pre-trade risk management requirements and pre-trade risk checks at the DCM level for all exchange members. While it is, of course, important to continue to learn and enhance risk management techniques, we believe that appropriate risk management rules and procedures are in place in exchange traded futures.

With respect to large orders and disruptive trading activity, firms executing large orders already have strong business incentives to minimize the market impact of such orders. That said, it would be impractical to require a firm placing a large trade to guarantee a non-disruptive market outcome, even if they did everything right, simply due to the myriad other factors that can impact the behavior of markets at any given point in time. A more practical solution to market disruptions would be to continue to implement, monitor and calibrate common sense safeguards such as limit-up/limit-down mechanisms, price-banding and others that make our markets more resilient during times of market duress. More study is needed to determine whether one, or a combination of these protections, would be the best approach.

8. *The Committee recommends that the SEC evaluate the potential benefits which might be gained by changes in maker/taker pricing practices, including building in incentives for the Exchanges to provide for “peak load” pricing models.*

Exchanges have a great incentive to attract liquidity and compete vigorously to do so. Furthermore, exchanges have a great deal of flexibility around pricing as evidenced by a host of exchange pricing models. Peak load pricing may be impractical to implement and may have little to no impact on order routing practices during extreme market events. During periods of high volatility and diminished liquidity, there is a strong incentive for firms to provide liquidity as spreads are wider and liquidity is at a premium. In fact, periods of high volume and volatility present significant opportunities for firms that are able to manage their risks and continue to trade. The incentives already inherent in the markets are far greater than pricing tweaks that exchanges may make. Steps such as an improved price banding and/or a limit-

up/limit-down approach, circuit breakers, unambiguous erroneous trade policies, and the elimination of stub quotes, will help reduce uncertainty and thereby enhance the ability of firms to manage risk and continue trading during extreme market events.

9. *The Committee recommends that the SEC evaluate whether incentives or regulations can be developed to encourage persons who engage in market making strategies to regularly provide buy and sell quotations that are “reasonably related to the market.”*

We share the Committee’s concern about depending on market maker obligations as a “guarantee” of market liquidity during periods of market stress. Not only would the benefits likely be illusory, a privileged regulatory status provided to selected market makers would create unfair advantages over other market participants, dampening competition and, therefore, likely reducing liquidity, including during times of market stress. Furthermore, the cost of the reduction in competition and liquidity would be borne by all other investors in the form of wider spreads, increased volatility and higher trading costs.

Finally, we note that exchanges have already eliminated market maker stub quotes and replaced them with quoting requirements that require quotes within a certain percentage of the inside market (i.e., to be “reasonably related to the market”).

10. *The Committee recommends that the SEC and CFTC explore ways to fairly allocate the costs imposed by high levels of order cancellations, including perhaps requiring a uniform fee across all Exchange markets that is assessed based on the average of order cancellations to actual transactions effected by a market participant.*

We agree with the Committee that there are valid and beneficial reasons for algorithmic strategies to have high cancellation rates. It is also worth noting the substantial differences between equity and futures markets that contribute to differences in order-to-execution ratios. Equities markets are highly fragmented. Market participants often provide liquidity across several competing venues, which ultimately leads to liquidity providers having more open orders and higher order-to-execution ratios. In addition, a substantial portion of equities orders are internalized or executed in dark pools. These over-the-counter executions deprive the displayed markets of executions, likely leading to higher order-to-execution ratios. Mandatory order cancellation charges may also harm competition as new markets typically have higher order-to-execution ratios during their ramp-up periods.

It is also important to note that the cost of processing message traffic is not equal across market participants. Some market participants may be able to process market data more efficiently than others and other market participants may choose to receive less or different market data in order to better fit their needs.

While we recognize that message traffic may impact all market participants, we note that some markets, like the CME, already have in place order-to-execution ratio parameters, which attempt to serve a similar function as charging for orders or cancels over a certain threshold.

We believe that equities venues can similarly implement policies designed to encourage efficient messaging. We believe these policies are better implemented by the exchanges than by regulatory fiat.

Finally, we note that mandating particular order-to-execution ratios is not an entirely effective means of control. It is illogical that a firm would be prevented from engaging in a trading strategy that placed an excessive number of orders for each execution by itself, but would be allowed to operate the same strategy if it were coupled with enough other, low order-to-execution strategies. Whether a pattern of behavior should be discouraged should not be based on whether other, unrelated patterns happen to be present as well. (It would also be impractical to attempt to distinguish between multiple trading strategies.) Because of such unintended consequences, we believe that markets looking to enact policies to encourage efficient messaging would be better served by something other than order-to-execution ratios. To be clear, we would not advocate an overall increase in fees. However, it may be reasonable for market operators to allocate some of their charges to message traffic, rather than executions

11. *The Committee recommends that the SEC conduct further analysis regarding the impact of a broker-dealer maintaining privileged execution access as a result of internalizing its customer's orders or through preferencing arrangements. The SEC's review should, at a minimum, consider whether to (i) adopt its rule proposal requiring that internalized or preferenced orders only be executed at a price materially superior (e.g., 50 mils for most securities) to the quoted best bid or offer, and/or (ii) require firms internalizing customer order flow or executing preferenced order flow to be subject to market maker obligations that requires them to execute some material portion of their order flow during volatile market periods.*
12. *The Committee recommends that the SEC study the costs and benefits of alternative routing requirements. In particular, we recommend that the SEC consider adopting a "trade at" routing regime. The Committee further recommends analysis of the current "top of book" protection protocol and the costs and benefits of its replacement with greater protection to limit orders placed off the current quote or increased disclosure of relative liquidity in each book.*

We believe the issues addressed by recommendations 11 and 12 are important market structure issues worthy of further analysis and study. Observers have long questioned how internalization and other forms of trading away from public markets impact market quality during normal market conditions. The disorderly markets of May 6 also raised important questions about how these practices impact market resiliency.

Any changes in the current policy regarding internalization and off-exchange trading could have a profound impact on investors and market structure. In guiding any policy changes in this area, we believe that the SEC should focus on policy that (1) lowers transaction costs and improves execution quality for investors, (2) improves market resiliency, and (3) encourages price discovery on public markets.

We note that several steps other than a “trade at” rule could also be considered to accomplish these objectives. These include no longer prohibiting choice (locked) markets in which investors have the opportunity to buy and sell a security with a zero bid-ask spread, and allowing sub-penny quoting and trading in securities that demonstrate a likelihood of benefiting from a reduced minimum price variation (along the lines of the “intelligent tick size” proposal made last year by several exchanges).

With respect to the suggestion that the SEC analyze greater protection than the current top of book protection, we do not believe that increasing protection to depth of book would have a material change on market quality or execution quality. It would, however, increase the complexity and cost of compliance. Firms trading on their own behalf have an incentive to achieve best execution on their orders. Intermediaries trading on behalf of investors have an obligation of best execution. If intermediaries route orders in such a way that does not seek available liquidity resulting in worse prices for their customers, their activity should be scrutinized under existing best execution rules. Proscribing how orders should be executed is not likely to result in better execution quality.

13. *The Committee recommends that the Commissions consider reporting requirements for measures of liquidity and market imbalance for large market venues.*

While a reporting requirement may be an interesting idea in concept, the data required to create such tools is already widely available in the event that a market or other market participants wanted to create such a measure. Therefore, the justification for additional reporting requirements is not clear at this time.

14. *The Committee recommends that the SEC proceed with a sense of urgency, and a focus on meaningful cost/benefit analysis, to implement a consolidated audit trail for the US equity markets and that the CFTC similarly enhance its existing data collection regarding orders and executions.*

We agree that regulators should have access to the full spectrum of order audit trail information. We believe that this can be done in a cost effective manner by leveraging existing audit trail information and exchange data repositories.

Mr. David Stawick, Secretary
Ms. Elizabeth M. Murphy, Secretary
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Thank you again for the opportunity to comment as regulators consider steps to create greater certainty and safeguard the markets.

Sincerely,

/s/ Richard B. Gorelick
Richard B. Gorelick
Chief Executive Officer
RGM Advisors, LLC

/s/ Adam Nunes
Adam Nunes
President, HRT Financial LLC
Hudson River Trading LLC

/s/ Cameron Smith
Cameron Smith
General Counsel
Quantlab Financial, LLC

cc: Mary Schapiro, Chairman, SEC
Gary Gensler, Chairman, CFTC
Luis Aguilar, Commissioner, SEC
Kathleen Casey, Commissioner, SEC
Troy Paredes, Commissioner, SEC
Elisse Walter, Commissioner, SEC
Michael Dunn, Commissioner, CFTC
Jill Sommers, Commissioner, CFTC
Bart Chilton, Commissioner, CFTC
Scott O'Malia, Commissioner, CFTC
Brooksley Born, Arnold & Porter LLP
Robert Engle, NYU Stern School of Business
Joseph Stiglitz, Columbia University
Richard Ketchum, FINRA
David Ruder, Northwestern University
Susan Phillips, The George Washington University
John Brennan, The Vanguard Group, Inc.
Maureen O'Hara, Cornell University