MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

September 12, 2010

Via Electronic Mail: Jointcommittee@cftc.gov; rule-comments@sec.gov

Members of the Joint CFTC-SEC Advisory Committee
On Emerging Regulatory Issues:

The Hon. Mary Schapiro, Chairman, Securities and Exchange Commission ("SEC")
The Hon. Gary Gensler, Chairman, Commodity Futures Trading Commission ("CFTC")
The Hon. Brooksley Born, Former Chairman of the CFTC
Jack Brennan, Former Chief Executive Officer and Chairman, Vanguard
Robert Engle, Michael Armellino Professor of Finance at the NYU Stern School of Business
Richard G. Ketchum, Chairman and Chief Executive Officer, FINRA
Maureen O'Hara, Professor of Management, Professor of Finance, Cornell University
The Hon. Susan Phillips, Dean and Professor of Finance, The George Washington University School of Business
The Hon. David S. Ruder, William W. Gurley Memorial Professor of Law Emeritus, Northwestern University School of Law; Former Chairman of the SEC
Joseph Stiglitz, Professor of Finance and Business, Columbia University

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F St., NE
Washington, DC 20549

Re: Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues ("Advisory Committee")

Dear Members of the Joint CFTC-SEC Advisory Committee:

Managed Funds Association ("MFA") [1] appreciates the solicitation of investor perspectives by the SEC, CFTC, and Joint SEC-CFTC and Advisory Committee as you review the market events of May 6, 2010. [2] MFA represents the views of institutional investors, including registered investment advisers and private investment pools, whose investors include pensions, endowments, foundations and insurance companies. We would like to share our views

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

[2] 75 *FR* 44781 (July 29, 2010).

on market structure issues and some proposals that have been made relating to the events of May 6, 2010.

Despite the events of May 6, 2010 we believe that the U.S. equity market structure developments have greatly benefited investors as transaction costs, fees, execution speed, efficiency, and pricing transparency/reliability have steadily and drastically improved over the past decade.[3] As the SEC, CFTC (together the "Commissions"), and the Advisory Committee analyze and consider reforms, we respectfully urge that you proceed cautiously and introduce changes that are supported by empirical data. The recent global financial crisis and continuing economic weakness are likely larger contributors to the general market uncertainty than any particular trading rule or practice. We are concerned that regulatory changes not supported by empirical data and directed at preventing rare market dislocations, could further harm investors by decreasing daily market liquidity and raising transaction costs.

BACKGROUND

In considering market structure changes, we believe it is important to note that the events of May 6, 2010 were not unique and that investors have previously experienced similar, sharp market dislocations. A relevant example occurred decades ago, well before recent innovations and changes in market structure.[4] On May 28, 1962, the Dow Jones Industrial Average fell sharply in 20 minutes, with some stocks falling by as much as 9% in 12 minutes.[5] This market event became known as the "Market Break of 1962" and was one of the subjects of the SEC's 1963 Special Study of the Securities Markets ("1963 Special Study").[6] Both "market breaks" in 1962 and 2010 happened suddenly and erratically, and in both cases liquidity seemed to

[3] *See* Appendix A for statistics on market data. From our members' analyses of their own market data and transaction costs, we are convinced that high frequency trading methods and low latency technology delivers important benefits to investors and to our markets.

The SEC's equity market regulations, including implementation of the Order Handling Rules, Regulation ATS, decimalization and Regulation NMS, have greatly improved the equity markets by removing anticompetitive barriers and promoting fair access to markets and market information. In doing so, the SEC's regulations have fostered innovations in technology that have revolutionized investing in our equity markets, and promoted greater competition among marketplaces, to the benefit of investors. Most notably, the advancements in technology have empowered investors, both institutional and retail, with more sophisticated and efficient methods to access the markets and execute their investment strategies globally. In the process, these equity market developments have led to greater market liquidity and depth, tighter bid-ask spreads and lower transaction costs. These changes lower the cost of capital and enhance economic growth. *See* letter to Elizabeth M. Murphy, Secretary, SEC, from Stuart J. Kaswell, Executive Vice President and Managing Director, Managed Funds Association on May 7, 2010 (providing comments on the SEC's Concept Release on Equity Market Structure) *available at:* http://www.managedfunds.org/downloads/MFA%20Mkt%20Structure%20Ltr.5.7.10.pdf.

[4] 1963 Special Study of the Securities Markets, Ch. XIII – The Market Break of May 1962 (hereinafter "1963 Special Study"), *available at:* http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1960/1963_SSMkt_Chapter_13_1.pdf. *See also* Take Heed the Lessons from the 1962 Flash Crash, Ian Domowitz, June 21, 2010 *available at:* http://www.advancedtrading.com/exchanges/showArticle.jhtml?articleID=225700888.

[5] Back to the Future: Lessons from the Forgotten 'Flash Crash' of 1962, Jason Zweig, The Wall Street Journal, May 29, 2010.

[6] 1963 Special Study.

evaporate for a brief period of time. Just as electronic market makers are said to have retreated on May 6, 2010, New York Stock Exchange specialists shifted to selling on May 28, 1962 and did not intervene to slow the decline.[7]

We believe these types of market breaks have complex causes that cannot be solely attributed to evolution in electronic trading or changes in market structure; trading in 1962 occurred on exchange floors or by telephone, well before the advent of electronic communication networks and dark pools, high frequency trading, and computerized systems. Events on both days were impacted by complex interactions involving multiple elements.[8] Indeed, the 1963 Special Study states:

> The history of the May 28 market break reveals that a complex interaction of causes and effects—including rational and emotional motivations as well as a variety of mechanisms and pressures—may suddenly create a downward spiral of great velocity and force. This, in turn, may change the impact of various normal market mechanisms, and thus temporarily impair the market's fair and orderly character.[9]

While the specific circumstances were different almost 50 years ago, the basic elements of the two events are strikingly similar: highly skittish investors found themselves unable to access accurate market data, so they retreated from the markets. When a market participant is unable to access accurate market data, it is likely to take a "wait-and-see" approach before buying or selling securities. A market participant doing otherwise could violate its risk management parameters or be deemed to be reckless and irresponsible by underlying investors, shareholders and regulators.

COMMENTS TO PROPOSALS

MFA supports the SEC and self-regulatory organizations' proposals to adopt uniform market-wide single stock circuit breakers and clearly erroneous trade rules.[10] We believe these reforms will serve to prevent market disruptions during times of market stress, help restore confidence in the markets and limit harm to investors. We would also support refinements to these rules that would address concerns that most trading halts to-date have been triggered by erroneously reported prices, not actual market activity. Allowing such circumstances to halt trading of stocks is inefficient and creates opportunities for market manipulation. We also generally support some other ideas that have been discussed, such as banning stub quotes, implementing market-wide circuit breakers, and expanding the bandwidth for market data to ensure timely quotations, all of which may prevent some market events from cascading into a crisis, and we would look forward to commenting on such proposals when details emerge.

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[7] 1963 Special Study.

[8] *See* 1963 Special Study *and* Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues dated May 18, 2010, CFTC and SEC Preliminary Findings Regarding the Market Events of May 6, 2010, *available at*: http://www.sec.gov/sec-cftc-prelimreport.pdf.

[9] 1963 Special Study at chapter XIII, at page 209-210.

[10] *See* letter to Elizabeth M. Murphy, Secretary, SEC, from Stuart J. Kaswell, Executive Vice President and Managing Director, Managed Funds Association on May 7, 2010 (providing comments on proposals from self-regulatory organizations to impose circuit breakers to halt trading) *available at: http://www.managedfunds.org/downloads/MFA%20Comments%20on%20Stock-by-Stock%20Circuit%20Breakers.pdf*.

Some market participants are urging regulators to introduce stricter, more binding market maker obligations on investors and traders. We do not believe that more stringent market maker obligations for such firms will prevent a future market break. Imposing market maker-like obligations on non-market makers may perversely lead to less liquidity in the equity markets. U.S. equity markets are the most liquid and have the lowest transaction costs in the world, because our market structure attracts a high number of buyers and sellers, who as a result, are not dependent on transacting through a middle man and pay lower transaction costs.[11] Requiring market participants, including certain investors, to register as market makers could decrease liquidity as many may not be able to commit to meeting market maker obligations, such as broker-dealer capital and margin requirements. As a consequence, such participants would be forced to curtail their trading/investing strategies. With fewer buyers and sellers competing to provide better prices in the markets and greater reliance on registered market makers, bid-ask spreads would, leading to higher transaction costs for all investors. In particular, trading costs for retail investors, who tend to trade at or close to the bid-ask spread, would rise in direct proportion to changes in spreads.

We are also concerned that proposals to expand the use of speed bumps, delay trading or set maximum execution speeds would cause greater harm to investors by increasing trading and transaction costs. Limiting trading activities and strategies will only harm everyday liquidity and price continuity with no evidence of efficacy in times of severe stress. Accordingly, we respectfully urge the Commissions to limit regulatory experimentation in what we would argue are the most efficient and effective markets in the world, the U.S. equity markets.

We note that throughout the Financial Crisis of 2008 and the steep decline in equity prices, the U.S. equity and futures markets operated remarkably well, whereas the markets of other, more dealer-dependent asset classes effectively froze, including the credit, fixed income and over-the-counter derivatives markets. Equity and futures market participants using high frequency trading methods and low latency technology remained in the markets trading throughout these difficult months. The equity and futures markets remained relatively liquid during those times of severe market stress when many dealers were under stress, including the failure or near failure of several large market-making financial institutions.

(Continued on next page)

[11] We note that under Section 11A of the Securities Exchange Act of 1934, Congress directs the Commission that "[i]t is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure . . . an opportunity, . . . , for investors' orders to be executed without the participation of a dealer."

As investors, MFA's members have a strong interest in liquid and deep markets that operate efficiently. We, therefore, hope we can continue to work with the Commissions, its staff and the Advisory Committee to address issues related to the events of May 6, 2010 and to market structure more generally. If you have questions or comments on the foregoing, please do not hesitate to call Jennifer Han or the undersigned at (202) 367-1140.

Respectfully submitted,

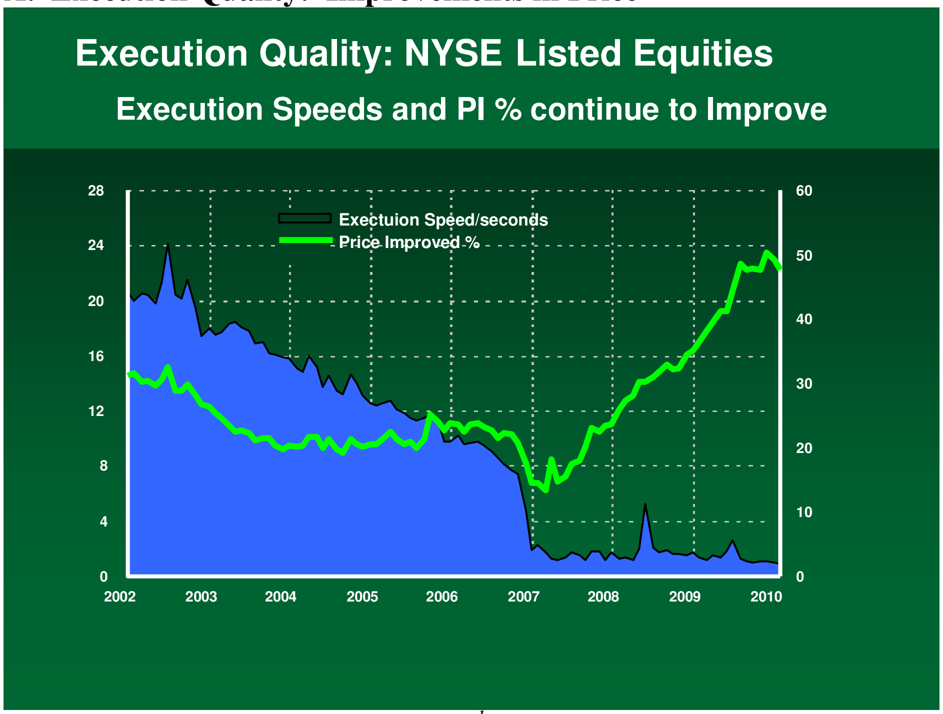
/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

CC: The Hon. Michael Dunn, Commissioner, CFTC
The Hon. Kathleen L. Casey, Commissioner, SEC
The Hon. Jill E. Sommers, Commissioner, CFTC
The Hon. Bart Chilton, Commissioner, CFTC
The Hon. Elisse B. Walter, Commissioner, SEC
The Hon. Luis A. Aguilar, Commissioner, SEC
The Hon. Troy A. Paredes, Commissioner, SEC
The Hon. Scott D. O'Malia, Commissioner, CFTC
Robert W. Cook, Director
Division of Trading and Markets, SEC
James Brigagliano, Deputy Director
Division of Trading and Markets, SEC
Richard Shilts, Acting Director
Division of Market Oversight, CFTC
Stephen Sherrod, Acting Deputy Director
Division of Market Oversight, CFTC

APPENDIX A
MARKET TRENDS

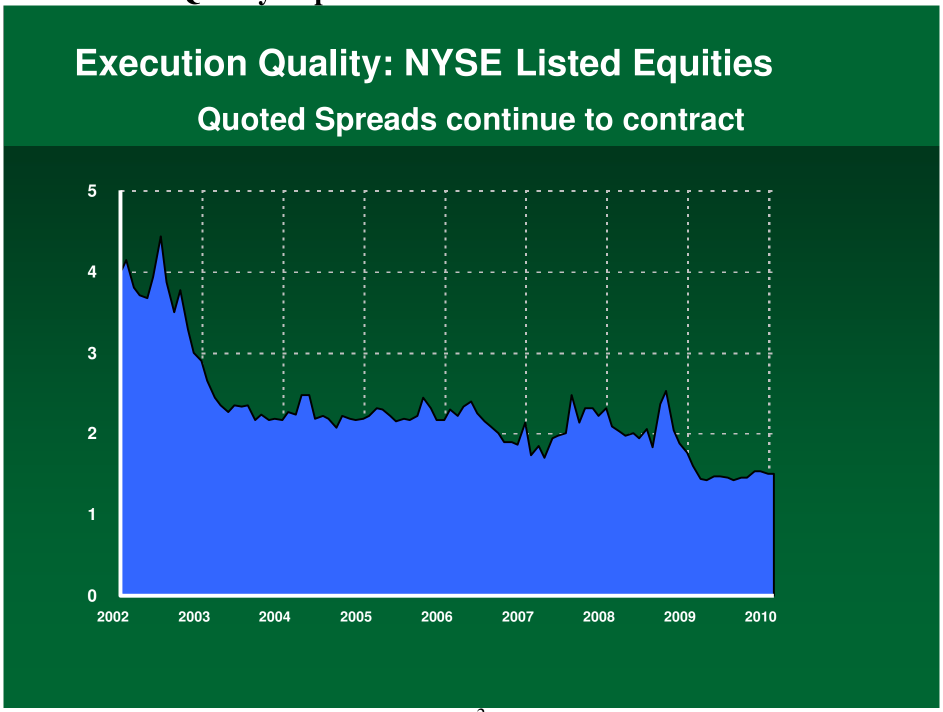
A. Execution Quality: Improvements in Price



Source: Thomson Transaction Analytics[1]
Note: All NYSE stocks, All market centers, All executed <u>market</u> order shares (605-reported, 100-9999 shares)

[1] Provided by Citadel Investment Group, LLC.

B. Execution Quality: Spreads Narrow



Source: Thomson Transaction Analytics[2]
Note: All NYSE stocks, All market centers, All executed market order shares (605-reported, 100-9999 shares) (Spread measured in pennies.)

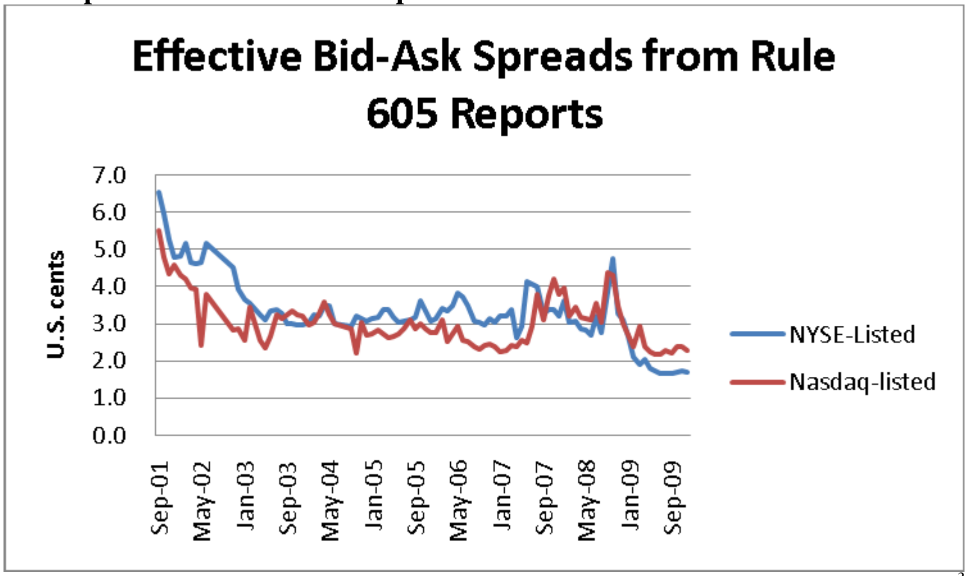
C. Changes in Quoted Spread, As Adjusted for Variations in Volatility

	Change in Quoted Spread from 2002-2006 to April 2007-July 2009				Change in Percent			
VIX ®	All NYSE	NYSE 100	All Nasdaq	Nasdaq 100	All NYSE	NYSE 100	All Nasdaq	Nasdaq 100
<15%	-$0.0176	-$0.0035	-$0.0494	-$0.0135	-11.0%	-19.9%	-31.6%	-48.4%
15-25%	$0.0314	-$0.0016	-$0.0094	-$0.0087	17.4%	-7.5%	-5.5%	-28.0%
25-35%	$0.0450	-$0.0088	$0.0361	-$0.0015	23.9%	-29.0%	25.4%	-6.1%
35-45%	$0.0419	-$0.0174	$0.0350	-$0.0019	22.5%	-46.4%	23.3%	-10.4%

Source: NYSE Euronext
Note: Volatility is measured by the S&P 500 VIX®.

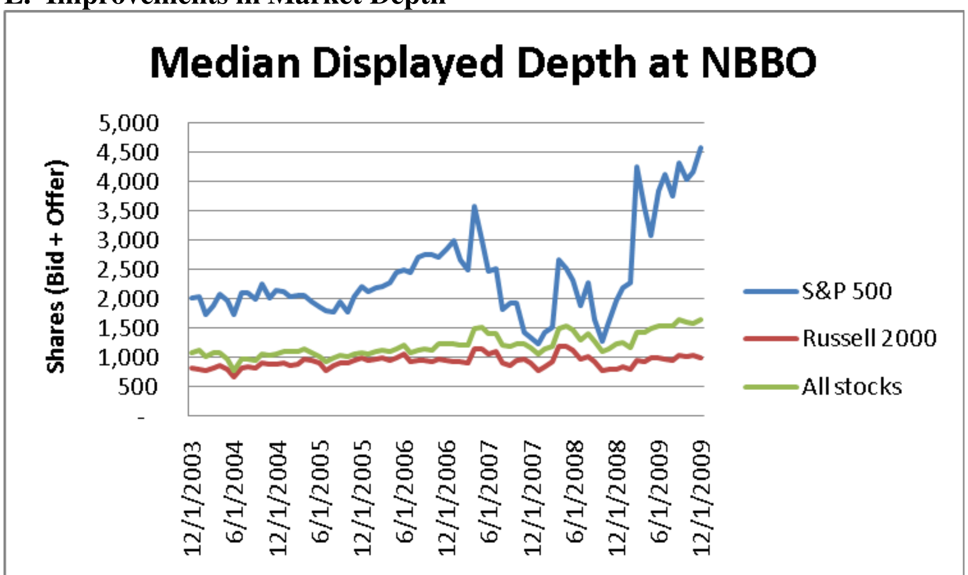
[2] Provided by Citadel Investment Group, LLC.

D. Improvements in Bid-Ask Spreads



Source: Public Rule 605 Reports from Thomson, Market orders 100-9999 shares[3]

E. Improvements in Market Depth

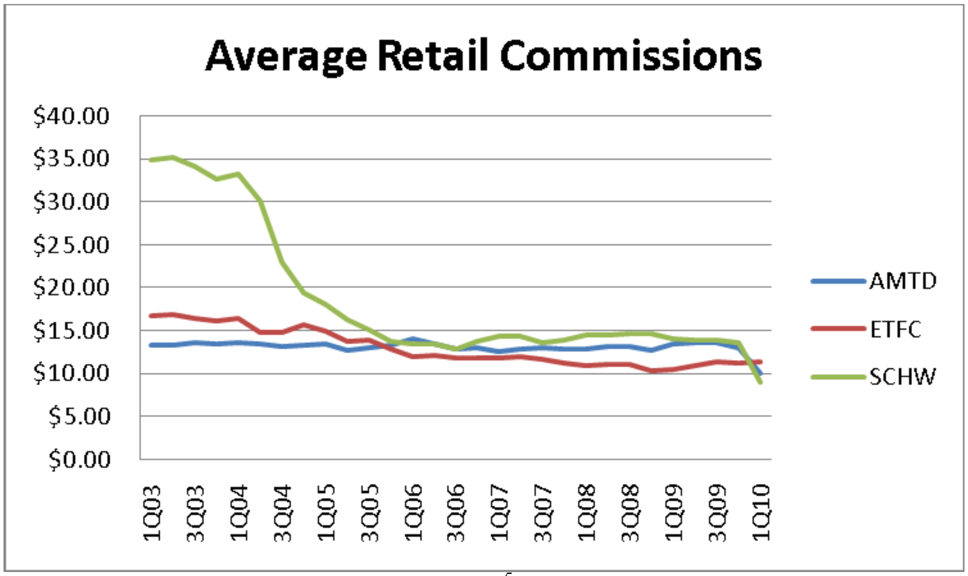


Source: Knight Capital Group[4]

[3] As cited by James J. Angel et al., Equity Trading in the 21st Century, February 23, 2010, *at* 10, *available at:* *http://www.knight.com/newsroom/pdfs/EquityTradinginthe21stCentury.pdf* (hereinafter "Angel et al.").

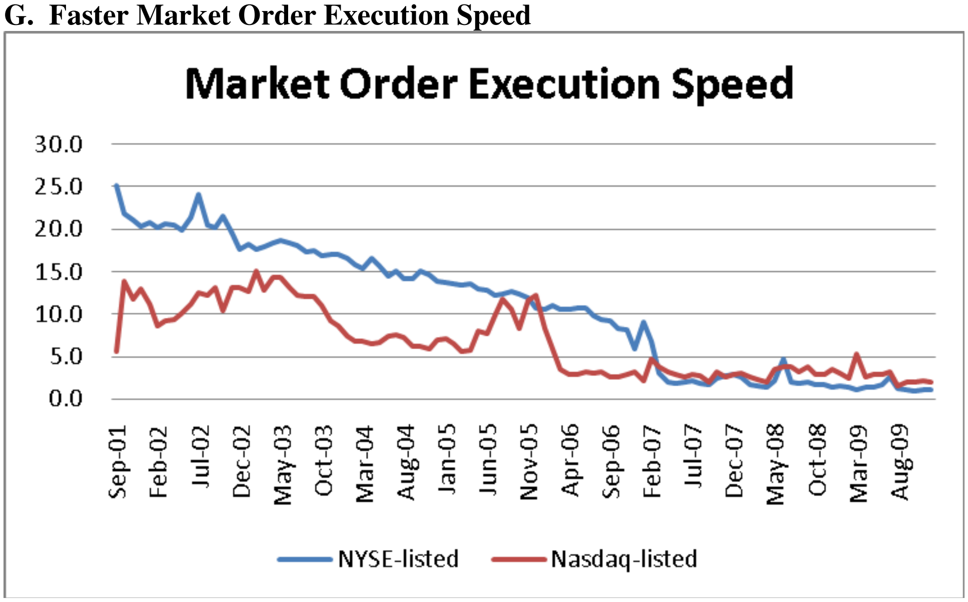
[4] As cited by Angel et al. at 14.

F. Lower Retail Commissions



Source: Barclays Capital Equity Research[5]

G. Faster Market Order Execution Speed



Source: Rule 605 data from Thomson for all eligible market orders (100-9999 shares)[6]

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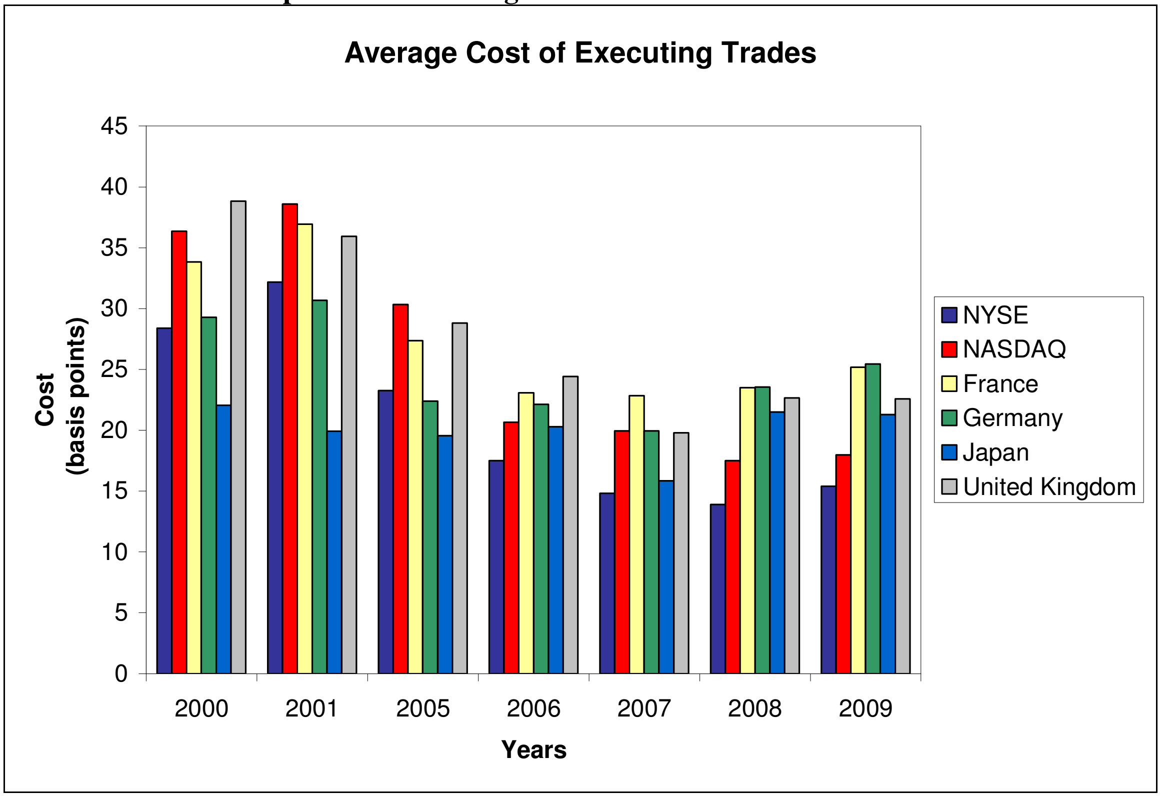
[5] As cited by Angel et al. at 18.

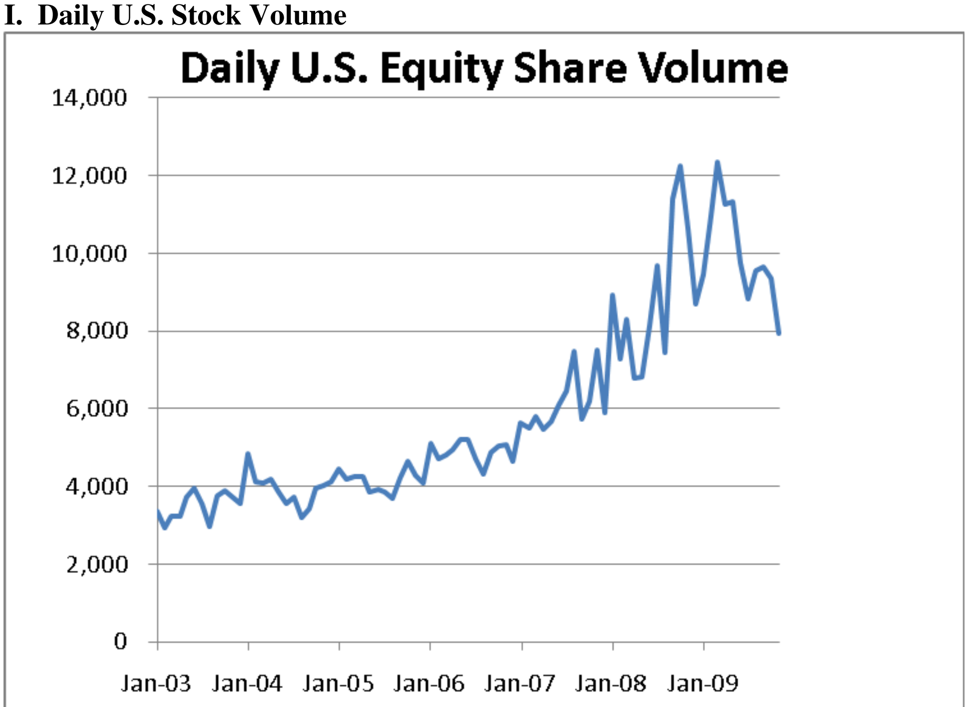
[6] As cited by Angel et al. at 22.

H. International Comparison of Trading Costs



Source: Elkins/McSherry, Institutional Investor

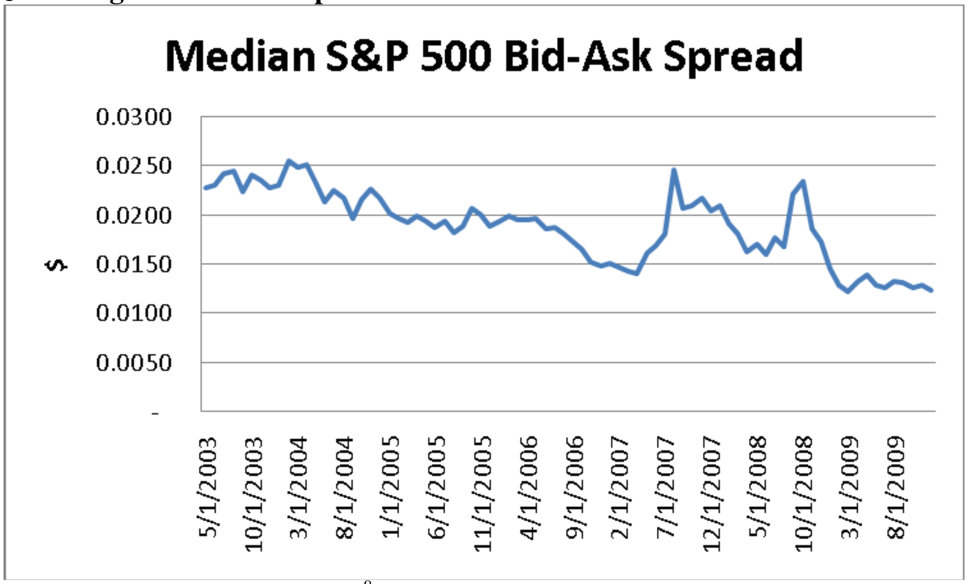
I. Daily U.S. Stock Volume



Source: Barclays Capital Equity Research[7]

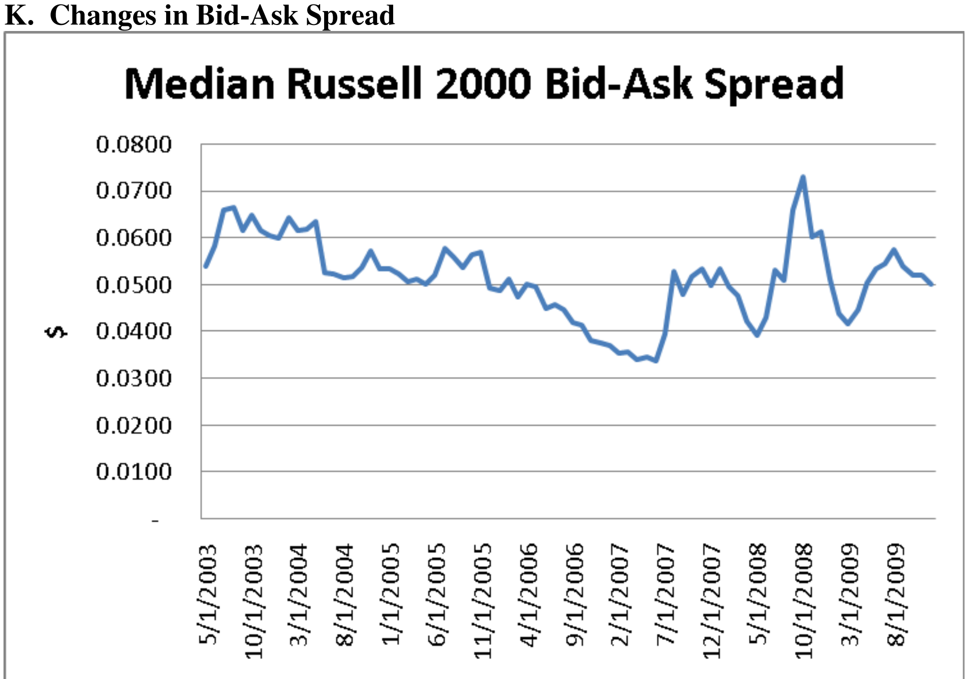
[7] As cited by Angel et al. at 7.

J. Changes in Bid-Ask Spread



Source: Knight Capital Group[8]

K. Changes in Bid-Ask Spread

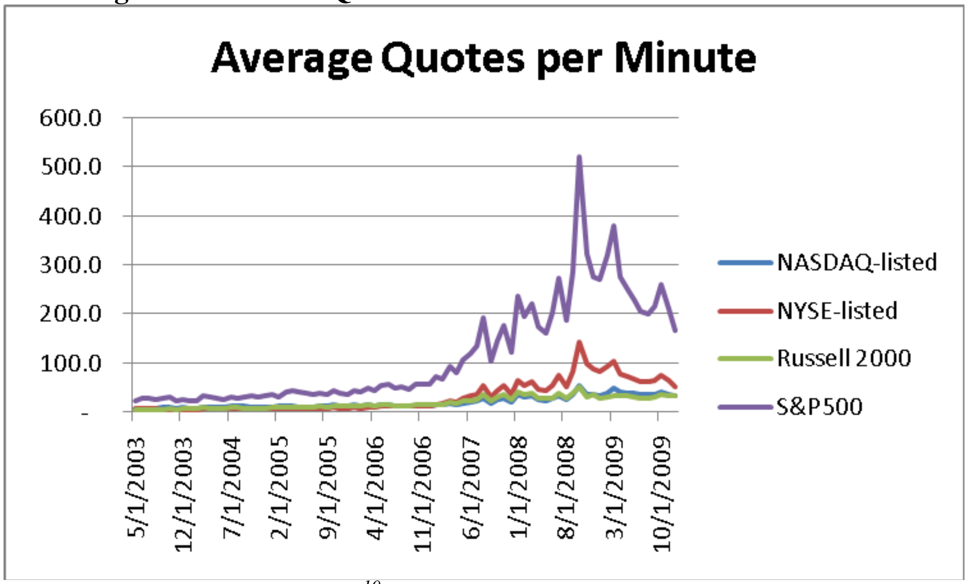


Source: Knight Capital Group[9]

[8] As cited by Angel et al. at 11.

[9] As cited by Angel et al. at 12.

L. Changes in Volume of Quotes



Source: Knight Capital Group[10]

[10] *Id* at 21.