September 14, 2010

Robert Cook
Director, Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: Market Safeguards

Dear Mr. Cook,

The market failure of May 6, 2010 was unacceptable and highlighted the need for improved and well-designed safeguards. Since that day, the Commission and exchanges have worked together to address this need, putting in place harmonized single stock circuit breakers and rules designed to address "clearly erroneous" trades. Recently, there have been a number of proposals to reform market structure, including some to impose obligations upon and provide corresponding advantages to some market participants. We continue to be supportive of meaningful reforms that improve the quality and resiliency of our markets, as they help to restore confidence in them. However, when considering reforms, policy makers should be mindful not to degrade competition and harm market quality.

As we described in April in our comment letter on the Commission's Concept Release on Equity Market Structure,[1] the U.S. equity markets have been dramatically transformed by reforms designed to increase competition by promoting openness and transparency. These changes resulted in a better market for investors and have contributed to narrower bid-ask spreads, increased depth of liquidity, more efficient prices and overall lower trading costs for investors.[2] The Commission now has the opportunity to maintain these gains, while dramatically reducing the likelihood and potential impact of future market failures.

[1] Comment letter of Allston Trading, LLC, Hudson River Trading LLC, Quantlab Financial, LLC and RGM Advisors, LLC dated April 23, 2010, available at http://www.sec.gov/comments/s7-02-10/s70210-155.pdf (the "Automated Professional Traders Comment Letter").

[2] Vanguard's Gus Sauter recently stated "[o]ur transaction costs have declined really by more than 50% in the last decade. And so we don't want to give that back." See https://www.vanguardeurope.com/international/europe/news/AudiocastFlashCrashTransEN.html. In addition, Larry Summers noted on March 18, 2010, at the Pew Charitable Trusts-sponsored "Financial Reform: Too Important to Fail" conference, "one of the things that economi[sts] have that's closest to the proverbial free lunch is the reduction of bid/ask spreads." See also the Automated Professional Traders Comment Letter for additional data about recent market quality improvements.

Some observers believe that one way to help prevent market failures would be to impose new obligations upon registered market makers.[3] While we would support proposals to replace stub quotes[4] with quotes at more meaningful prices within circuit breaker thresholds, we believe that the other suggested changes to the current market making framework would harm competition and raise costs for investors without protecting against market failures.

Increasing market maker obligations would come at a high cost. In exchange for meeting stricter obligations, market makers are generally given advantages over other market participants, which act like subsidies.[5] These advantages have typically involved preferential access to the markets, lower fees and informational advantages. These advantages come at a substantial cost for all investors as they degrade competition and raise barriers to entry for new participants. Since there appears to be broad agreement that increased obligations would not prevent market failures, this cost is simply not justified.[6]

None of the proposed market maker obligations would force market makers to "catch a falling knife" or buy in the face of overwhelming selling. As Michael Mendelson of AQR Capital Management recently stated at a joint SEC-CFTC hearing, "the function of a market maker is not to buy stock at the wrong price as a market is crashing."[7] Indeed, during market breakdowns such as 1987's "Black Monday," specialists did not buy in an effort to counter rapid price declines but instead halted trading and then re-opened trading at new equilibrium prices. The recently instituted circuit breakers are an excellent start to replacing that important function on automated markets and could perhaps be improved through a limit up/limit down approach.

Fortunately, policy makers do not need to choose between overall market quality and resiliency against market shocks. Well-designed safeguards like circuit breakers, better rules for erroneous trades, and the replacement of stub quotes will help prevent future market failures while preserving the market quality improvements of the past decade.

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[3] See Sen. Ted E. Kaufman, letter re: Ongoing Market Structure Review, available at: http://www.sec.gov/comments/s7-27-09/s72709-96.pdf (the "Kaufman Letter"); John A. McCarthy (Getco, LLC), Christopher R. Concannon (Virtu Financial, LLC) and Leonard J. Amoruso (Knight Capital Group, Inc.), letter re: Market Maker Obligations dated July 9, 2010, available at http://www.sec.gov/comments/s7-02-10/s70210-255.pdf (the "Getco/Virtu/Knight Letter); Sen. Charles E. Schumer letter dated August 11, 2010, available at http://schumer.senate.gov/new_website/record.cfm?id=327160 (the "Schumer Letter").

[4] A stub quote is an order placed by a market maker far away from a stock's market price to fulfill quoting obligations imposed by an exchange when the market maker does not desire to trade.

[5] See, e.g. the Schumer Letter and the Getco/Virtu/Knight letter.

[6] Even proponents of new market maker obligations acknowledge that they would not prevent another May 6th-like failure: Senator Kaufman recently wrote that "…no degree of affirmative or negative obligations will totally prevent another flash crash – as traders will never be willing to stand in front of a freight train of sell orders 100 percent of the time..." (see Kaufman Letter at Attachment p.3); and three trading firms advocating for new market making obligations recognized that "...no set of market maker rules could have prevented May 6..." (see Getco/Virtu/Knight Letter at p.1.)

[7] Testimony of Michael Mendelson, Principal at AQR Capital Management LLC, before the August 11, 2010, CFTC-SEC Joint Advisory Committee Meeting on Emerging Regulatory Issues, available at http://sec.gov/spotlight/sec-cftcjointcommittee.shtml and http://www.cftc.gov/PressRoom/Events/opaevent_cftcsec081110.html ; prepared testimony available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcsecac_mendelson.pdf.

Thank you for the opportunity to comment on these matters.

Sincerely,

/s/ Liam Connell
Liam Connell
Chief Executive Officer
Allston Trading, LLC

/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
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