Topics for consideration by the Obama Transition Team
Telephonic Call with Gary Gensler
December 5th, 2008

Market Orders (and collars) & Clearly Erroneous Policies – In a fragmented market structure, it can be difficult for even the smartest participants to see the real picture of available liquidity across all market centers. Race conditions, flickering quotes, slow market indications, etc. can distort the perception of available liquidity. Also, with so many market centers, it may be more probable that the depth "behind the inside" is thin in one or more locations. This combination of factors opens up the possibility of run-away market orders bleeding through the books of different market centers and creating unexpected executions.

0.0030 access fee cap – Today's market place has a hard 0.0030 access fee cap for removing liquidity from a displayed market. We question whether this is still an appropriate level of fee cap. For lower volume stocks, this cap/limit may be artificially keeping spreads wider than they would be if higher rebates were available to liquidity providers.

Multiple books per SRO – The current landscape of SRO's includes NYSE and Nasdaq each owning 3 separate registered exchange books. That provides them with the ability to try different market structure and price experiments without impacting their primary market. The historical path for an exchange to operate a second book is to buy another market (i.e. a regional SRO). We question whether this is the most efficient way to move forward with a second book, as the weight of taking on somebody else's legacy provides significant risk.

Market Maker Status/Exemptions in a fully automated world – Today's market is very different from the market 10 years ago with regards to who provides liquidity and how that liquidity is provisioned. Some estimates put 50% to 70% of shares executed each day with an automated liquidity provider on one side. The new market makers and how they operate need to be taken into account if the definition of Market Maker comes into question for policy purposes. We believe any SEC rules, exemptions, or policies that involve the term "Market Maker" need to be examined/reviewed in light of the prevalent market markets in the industry currently.

Short Selling – The ability to engage in short selling is fundamental to the healthy provision of liquidity in the market. That said, manipulative short selling, as with any manipulative securities transaction, is detrimental to the fair and orderly functioning of a market. This past fall, the SEC took steps to address potentially manipulative short selling through emergency rule making by targeting naked short selling and fails to deliver and by imposing temporary bans on short selling in the securities of specific companies. Any further regulatory initiatives by the SEC should be proposed only after careful analysis of the impact of these emergency measures and should be subject to ample opportunity for public consideration before being imposed on the industry.

Options Markets – Unlike the equity markets, payment for retail order flow is prevalent in the options markets relative to the routing of retail customer options orders. In the equity markets, decimal pricing, regulations requiring the publication of standardized order execution quality information, and Regulation NMS have all contributed to reduce the costs of order execution and the eradication of entrenched payment for order flow relationships. The implementation of a penny pilot for certain options classes and the development of the maker-taker exchange model has put pressure on some of these payment for order flow relationships; however, the practice remains widespread. We question whether retail customer order flow that is the subject of such payments is in all cases receiving best execution, and we believe the SEC should continue to focus on this area, including reviewing options market structures, broker-dealer best execution policies and procedures, and the impact of the options penny pilot on order execution and payment for order flow.

Rule Filings – Much attention has been given to the SRO rule filing process, and the SEC has recently taken important steps to increase the efficiency of this process and consequently reduce the time to obtain SEC approval of rule changes. In the current landscape in which exchanges are engaged in vibrant competition against one another as well as against other non-exchange execution venues, we believe that no one execution venue can claim anything like a monopoly status that would enable them to exert undue influence over its market participants. Order flow is highly portable and can instantaneously be moved from one market to another. In light of this, concerns about the fairness or appropriateness of any new market initiative implemented by one exchange are likely not as great as they may have been even just a few years ago. If a market implements a new "rule" that is discriminatory or otherwise detrimental to the fair and orderly functioning of its market, members will vote with their feet and refuse to participate in that market. As such, while it remains important to subject SRO rule making to a notice and comment period, for the market rules of an SRO in particular, the SEC should consider the extent to which it can permit substantially more, if not all, such rules to be effective immediately upon filing and thereafter subject to a post-effective abrogation process.

SRO Regulation – Currently, each registered national securities exchange is responsible for comprehensive regulation of its market and the participants trading on its market. This can result in great inefficiency to the extent that multiple SROs are expending resources to examine the same firms for the same issues. In addition, because unlawful conduct can occur across multiple markets, a myopic view focused on the trading occurring on a single SRO's market can result in all SROs missing illegal conduct that occurs across multiple trading venues. Partially mitigating these inefficiencies, some markets contract with other SROs for the provision of certain regulatory services. The net result is a reduction for broker-dealers in receiving multiple examinations on the same subject from multiple SROs. In addition, the SEC has approved certain joint plans for the consolidation of insider trading regulation, such that multiple markets are not all required to surveil for potential instances of insider trading. More consideration should be given to consolidating certain regulatory functions where it enhances efficiencies and the ability to detect misconduct. Intermarket manipulation and front-running for example may benefit from such an approach, and we believe it would be a prudent time for the SEC to engage in a fresh examination of these issues.