The Pulse of Finance

Newedge

BY OVERNIGHT MAIL AND E-MAIL

April 21, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090
rule-comments@sec.gov

Re: Newedge Comment Letter -- File No. S7-02-10

Newedge appreciates this opportunity to comment on the Securities and Exchange Commission's ("SEC") Concept Release on Equity Market Structure ("Release"). Newedge refers to Newedge Group SA and all of its global subsidiaries, including Newedge USA, LLC. As you may know, Newedge is actively involved, both in the US and abroad, in working with regulators to develop rules and regulations designed to strengthen our financial markets.[1] Given our broad experience in the US and global futures, derivatives and securities markets, we feel we are strongly positioned to provide such input and, as noted, welcome the opportunity to do so.[2]

As an initial matter, we applaud the SEC for examining closely the current US equity market structure and, in particular, technological advances in the areas of high frequency trading and co-location. As noted in the Release, the "secondary market for U.S.-listed equities has changed dramatically in recent years," and the "primary driver ..... has been the continual evolution of technologies for generating, routing and executing orders."

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[1] Indeed, Newedge personnel routinely sit on futures and securities industry committees and task forces, participate in industry conferences and seminars, and comment on proposed SEC, CFTC and self-regulatory organization rules.

[2] We note that concurrent with the Release, the Committee on European Securities Regulation ("CESR") is also seeking information and views on similar technological advances that have occurred in the European equity markets, including high frequency trading, direct market access, co-location and un-displayed liquidity. See Micro-structural issues of the European Equity Markets, CESR/10-142 (1 April 2010). Newedge anticipates submitting a comment letter in response to the CESR's request as well.

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Indeed, high frequency trading is reported to account for as much as 60 percent of today's US equity trading volume. Without question, an assessment is needed to determine whether these technological changes are consistent with Congress' goals for a national market system.[3] While the SEC has raised a broad array of topics in the Release, we will confine our comments at this time to high frequency trading and co-location.

As a general matter, we believe that certain of the technological advances that have occurred in recent years, along with several key SEC rule changes, have led to positive developments in the equity markets.[4] For example, the ability to process market data quickly and transmit a large number of orders into the market within a short period of time – i.e., high frequency trading and co-location – has, in our view, helped to increase trading volume which, in turn, has helped to increase liquidity, narrow spreads, reduce commissions and reduce overall transaction costs. Similarly, the ability of exchanges and consolidated market data providers to disseminate large amounts of market data in very short time-periods has, in our view, increased market transparency. Consequently, we do not believe that high frequency trading, co-location and exchange data dissemination are, in and of themselves, harmful to the equity markets. Indeed, we believe that high frequency trading is highly beneficial to markets and should be encouraged, let alone be permitted.

However, as set forth below in more detail, we also believe that: (a) certain types of high frequency trading strategies, such as momentum ignition, may be detrimental to the marketplace and should be curtailed (to the extent they are not already prohibited), (b) certain other steps relating to high frequency trading – such as implementing industry-wide or "generic" DMA controls – should be advanced by regulators to "level the playing field" with respect to latency; and (c) co-location services must be regulated.

BACKGROUND

Newedge, which is one of the world's largest brokerage organizations, offers its customers clearing and execution facilities across multiple asset classes including futures, securities (fixed income and equities), options, FX and various OTC instruments.[5] Newedge maintains offices in over 15 countries, and is a member of over 80 exchanges worldwide. Newedge estimates that its customers -- who are principally institutional -- execute 6.4 million lots and clear 7.0 million lots, globally, on a daily basis.[6] Newedge USA is one of the leading BD/futures commission merchants ("FCM") in the US.

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[3] Congress' goals for a national market system include: the efficient execution of transactions; fair competition among brokers and dealers and between market centers; fair access to transactions and market data; the ability of brokers to provide best execution, and; an opportunity for investors' orders to be executed without the participation of a dealer (collectively, "NMS Goals").

[4] Among these important rule changes are, in our view: (a) Regulation ATS, which has fostered competition between exchanges and alternative market centers; (b) Regulation NMS which, in prohibiting "trade-throughs" has facilitated the execution of listed securities in the OTC market, and; (c) the limit order display rules, which have required market centers to give the best priced limit orders priority in terms of display and execution.

[5] "Newedge" refers to Newedge Group, a 50%-50% joint venture between Credit Agricole Corporate and Investment Bank (formerly Calyon) and Société Générale, headquartered in Paris, France, and all of its worldwide branches, subsidiaries and other units.

[6] For the year ended December 31, 2008.

Indeed, according to CFTC statistics, Newedge USA holds the largest pool of customer "segregated" and "secured" assets of all US-based FCMs as of December 31, 2009. Newedge USA's primary function is that of a broker -- i.e., to execute and clear customer transactions across multiple asset classes on either an agency or riskless principal basis. Newedge USA, which has been a joint BD/FCM since 1995,[7] conducts only a very limited amount of proprietary trading, and then generally only to hedge positions acquired through customer facilitation. As a result, Newedge USA does not generally hold positions in inventory, and never engages in high frequency trading for its own account.

That being said, Newedge USA is an active participant in the US and global equity markets, both as an executing and clearing broker. The Firm's equity clients typically are other US BDs and large US and non-US institutional clients (such as hedge funds, private investment vehicles, banks and professional trading organizations). Newedge USA offers qualifying clients direct market access ("DMA") trading through its own order routing systems and infrastructure, independent internet service providers ("ISV") and sponsored access arrangements. Many of Newedge USA's equity DMA clients are algorithmic or "black box" trading firms that engage in "high frequency trading."[8] In addition to its DMA activities, Newedge USA provides "live" equity brokerage services, and conducts prime brokerage and correspondent clearing services for hedge funds and introducing brokers, respectively. Newedge USA does not act as a dealer, market maker or specialist in equity securities, and conducts no banking or equity research services. Indeed, Newedge USA, which is a member of all major US equity exchanges and non-exchange market centers, rarely conducts equity proprietary trading, and then generally only to facilitate a customer execution.

DISCUSSION

1. High Frequency Trading

a. As a General Matter, We Believe High Frequency Trading Has Led To Many Positive Developments in Today's Equity Markets.

As noted above, Newedge does not believe that high frequency trading, in and of itself, has harmed the equity markets. Indeed, the evidence suggests that high frequency trading, as a general matter has, along with a number of important rule changes such as those mentioned above, had some very positive results. The ability of firms to process large amounts of market data quickly and transmit a large number of orders into the market in a short period of time has, in our view, helped to increase trading volume which, in turn, has helped to increase liquidity, narrow spreads, reduce commissions and

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[7] Through one of its predecessor entities, Fimat USA, LLC.

[8] Newedge agrees with the SEC that while the term "high frequency trading" is "relatively new and is not yet clearly defined," certain common characteristics are shared among high frequency traders including: (a) the use of high-speed and sophisticated computer programs for generating, routing and executing orders; (b) the use of co-location services; (c) the submission of numerous orders in a short period of time, many of which ultimately are cancelled, and; (d) ending the trading day in a flat or close to flat position.

reduce overall transaction costs. In terms of the speed and costs of execution, we believe the US equity markets are more efficient than ever before, and that high frequency trading has played a significant role in this development. Further, we believe this improved market efficiency has, in turn, led to an increase in foreign investment in our equity markets over the past three to five years.[9]

Moreover, we believe that high frequency trading, in certain instances, has decreased volatility in stocks and thereby had a stabilizing effect on the market as a whole. Indeed, with respect to certain stocks, it appears that high frequency traders have, on occasion, taken on the role of specialists or market-makers in "bridging the fluctuations between supply and demand that occur throughout the trading day."[10] As noted by Mr. Cameron Smith, General Counsel of Quantlab Financial, LLC, a Houston-based quantitative technology and trading company:

> If only long-term investors were trading securities, there would not be adequate liquidity to keep markets stable and spreads narrow. Therefore, market intermediaries, whether traditional market makers and specialists or today's high frequency traders, are essential.

We also believe that high frequency traders, in general, have helped to stabilize the market based on the market neutral and risk averse nature of their trading strategies. Indeed, high frequency traders generally do not speculate or even take overnight positions, which we believe has taken some of the volatility out of the market place.

In short, we believe that high frequency trading – along with several important SEC and self-regulatory rule developments – has helped to further a number of key NMS Goals, including competition among exchanges, competition between exchanges and non-exchange market centers, lower transaction costs and best execution. We also believe these same positive developments have helped "long-term investors," which appears to be a key concern of the SEC.[11] Among other things, as a result of increased liquidity and lower transaction costs, long-term investors, once they have determined to acquire or dispose of a stock, are often able to do so on a faster and less expensive basis. In addition, as a result of the stabilizing effects of high frequency trading in general, long-term investors are less susceptible to market volatility, and therefore, less likely to lose the value of their investment in a short period of time.

That being said, however, we also believe that certain types of high frequency trading strategies, such as momentum ignition, may be detrimental to the marketplace and should be prohibited (to the extent they are not already prohibited). We also believe that

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[9] We do note, however, that the increase in liquidity and decrease in spreads has occurred primarily among large-cap stocks; mid-cap and low-cap stocks appear to have felt less of the benefits of high frequency trading (as well as the aforementioned rule changes).

[10] See Commentary: How High Frequency Trading Benefits All Investors, Traders Magazine Online News, March 17, 2010, Cameron Smith.

[11] The SEC defines "long-term investors" to be market participants who provide capital investment and are willing to accept the risk of ownership in listed companies for an extended period of time.

regulators should take certain steps to "level the playing field" with respect to latency among high frequency traders.

b. Momentum Ignition High Frequency Trading Strategy

A "momentum ignition" trading strategy, as that term is generally defined, occurs when a high frequency algorithm initiates a series of orders and trades in an attempt to ignite a rapid price movement – either up or down – in a particular stock. The price movement is designed to trigger institutional algorithms which, once initiated, accelerate the price movement. The momentum ignition trader then profits by liquidating or covering a large position it established prior to the price movement. In our view, this practice constitutes "spoofing" and market manipulation, which is detrimental to the marketplace and should be prohibited to the extent it is not already.[12] Further, in addition to giving such traders an unfair advantage vis-à-vis other market participants, momentum ignition trading generally increases volatility in the market, which can make it more expensive for long-term investors to acquire or dispose of their positions.

c. Certain Additional Steps Are Required In Order to Level the Playing Field With Respect to High Frequency Trading.

In addition to combating predatory high frequency trading strategies, we believe that the SEC and FINRA should take certain additional steps to "level the playing field" with respect to high frequency trading, and thereby further the NMS Goals of fair competition among brokers and dealers and between market centers, and fair access to transactions and market data. Specifically, we recommend the following initial steps:

i. Co-location services, as we set forth below in Section 2, should continue to be permitted. However they should be transparent and regulated.

ii. Regulators should require that industry-wide or "generic" DMA controls be implemented. More specifically, as set forth in our March 29, 2010 comment letter regarding proposed SEC Rule 15c3-5, we believe that (a) certain broad-scale filters and controls – such as those relating to trading halts, Regulation SHO and Regulation NMS – should be implemented by exchanges at the exchange level, and (b) more customized controls – such as those relating to individual customer risk parameters – should be created by market centers and then provided to BDs for customization and use. Such a two-tiered approach will, in our view, help to "level the playing field" with respect to latency, and thereby de-emphasize the importance of hardware and increase the importance of trading skill, analytical research and knowledge of market behavior.

2. Co-Location

Co-location, in the context of the US securities markets, generally involves a high frequency trading firm locating its trading server(s) in close proximity to a market

[12] See SEC Rule 10b-5.

center's matching engine.[13] The advantage of co-location to high frequency traders is speed, in that it reduces the communication time between the trading firm's server and the market center's matching engine.[14] For the reasons set forth below, we believe co-location should be permitted, but regulated.

a. Co-Location Centers Support Market Efficiency and Reduce Systemic Risk.

From a purely performance perspective, a well-maintained co-location center can offer many significant advantages over housing one's trading server in a normal office location. For example, co-location centers often have (a) more reliable uptime, (b) better network speed and reliability, (c) better power redundancy, (d) more redundant and improved cooling and environmental air conditioning, (e) lower set-up and monthly costs, (f) more available network and server specialists, and (g) higher internet bandwidth availability than do normal business office locations. In addition, co-location space is still relatively inexpensive and readily available. We believe the significant storage and maintenance safeguards available at high quality co-location centers not only assist trading firms with the speed and accuracy of their executions, but reduce overall systemic risk to the markets. Consequently, we believe co-location facilities further the NMS Goals of market efficiency and stability, and should be permitted.

b. Co-Location Centers Must Be Regulated.

However, in order to ensure that co-location facilities are of high quality – and remain relatively inexpensive and readily available – we believe such facilities must be regulated closely by the SEC and/or FINRA. Indeed, given the fact that trading in today's markets is primarily electronic, and that trading servers and matching engines are the "lifeblood" of electronic trading, we do not believe the SEC would be over-reaching (in a jurisdictional sense) by regulating such venues. We also believe that to the extent the SEC were to disallow market centers from offering co-location services, non-regulated entities in close physical proximity to them would provide such services in an unregulated context, which could lead to low grade facilities and the unfair and unequal allocation of co-location space.

In determining regulatory requirements for co-location facilities, the SEC might want to consider the following:

i. Each facility must meet certain physical, systems, disaster recovery, maintenance and environmental requirements and safeguards.

ii. Each facility must be inspected by regulators at least once annually.

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[13] Co-location is commonly practiced today. Indeed, the NYSE is constructing a 400,000 square foot facility in Mahwah, New Jersey and another one outside of London, at a combined cost of $500 million to facilitate its members' co-location needs.

[14] It is estimated that co-location creates a 100-200 millisecond advantage over a regular vendor based provider.

iii. Services offered by co-location facilities must be transparent and available on consistent terms to all participants.

iv. Space within a co-location center must be allocated fairly so as not to give certain members a timing advantage.

v. Non-regulated entities providing co-location services, such as Equinix, must consent to and abide by such rules and regulations.

Importantly, we do not anticipate that market centers or even currently unregulated entities offering co-location facilities will object to such regulation. Indeed, Nasdaq recently consented to the SEC's regulation of its co-location facilities, including having to obtain SEC approval for certain pricing changes.

Thank you again for this opportunity to share our views on the Release and we invite you to contact the undersigned at (646) 557-8458 or at gary.dewaal@newedgegroup.com.

Sincerely,

Newedge USA, LLC

Gary Alan DeWaal
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and Group General Counsel