

**MEMO# 24968**

February 16, 2011

# **ICI Letter on IOSCO Review of Dark Liquidity**

[24968]

February 16, 2011

TO: EQUITY MARKETS ADVISORY COMMITTEE No. 14-11  
INTERNATIONAL MEMBERS No. 6-11  
INTERNATIONAL INVESTING SUBCOMMITTEE No. 5-11  
SEC RULES MEMBERS No. 33-11  
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 6-11  
ETF ADVISORY COMMITTEE No. 16-11  
CLOSED-END INVESTMENT COMPANY MEMBERS No. 22-11 RE: ICI LETTER ON IOSCO  
REVIEW OF DARK LIQUIDITY

The International Organization of Securities Commissions (“IOSCO”) has issued a public consultation (“Consultation”) on issues raised by dark liquidity. ICI has filed a letter, a copy of which is attached, on the Consultation. The most significant aspects of the letter are summarized below.

## **Funds Use of Dark Liquidity**

The letter discusses the various reasons why dark pools may be used by funds and, in general, the benefits of dark liquidity. The letter notes that funds have long been significant users of dark liquidity and the trading venues that provide such liquidity and that, most significantly, these venues provide a mechanism for transactions to interact without displaying the full scale of a fund’s trading interest. The letter recognizes, however, that while venues providing dark liquidity bring certain benefits to funds, there are concerns about the use of dark liquidity, particularly the impact on the price discovery process, the impact of potential fragmentation on information and liquidity searches, and the impact on market integrity due to possible differences in access to markets and information.

## **Draft Principles to Address Regulatory Concerns Regarding Dark Liquidity**

The letter supports the goals of the draft principles discussed in the Consultation to address

regulatory concerns surrounding dark liquidity. The letter recommends, however, that regulatory authorities take a measured approach to any responses they feel appropriate and necessary to address concerns and to carefully balance the potential costs and benefits that any new regulations would provide to investors. The letter also states that it will be important for regulatory authorities to consider the varying business models and trading mechanisms of dark pools. The letter notes that dark pools that operate in a manner more akin to broker-dealer trading venues arguably should be treated differently from other dark pools for purposes of regulation.

## **Principle 1: Pre-Trade Transparency**

The letter generally supports increasing pre-trade transparency of information about dark liquidity but urges regulators to examine any unintended consequences that may arise as a result of new requirements, particularly the impact on large orders executed by funds. The letter strongly supports exceptions provided to pre-trade transparency for large orders and cautions against drafting any such exceptions too narrowly. The letter also supports suggestions of treating “actionable indications of interest” as firm public quotes that should be displayed.

## **Principle 2: Post-Trade Transparency**

The letter generally supports increasing post-trade transparency of information about dark liquidity but states that exceptions to facilitate and ensure the efficient execution of large orders are critical. The letter also does not support real-time, post-trade transparency of the identity of individual dark pools but does support such disclosure on a delayed basis (i.e., at the end of the trading day, on a stock-by-stock basis).

## **Principle 3: Priority of Transparent Orders**

The letter strongly supports efforts to provide incentives for market participants to use transparent orders and states that the time is ripe for regulators to examine the impact of certain undisplayed liquidity on price discovery. The letter emphasizes that it is imperative that venues trading dark liquidity remain available to funds and that regulations overseeing these venues facilitate their continued use. The letter recommends that dark liquidity in the form of broker-dealer internalized order flow should be examined and that further action should be taken to ensure that internalized orders receive best execution.

## **Principle 4: Reporting to Regulators**

The letter states that it is important that regulators have access to accurate, timely and detailed information regarding dark liquidity.

## **Principle 5: Information Available to Market Participants about Dark Pools and Dark Orders**

The letter strongly supports suggestions that dark pools or transparent markets offering dark orders ensure that market participants are provided with detailed explanations of information about how orders are handled and executed.

## **Principle 6: Regulation of the Development of Dark Pools and Dark Orders**

The letter strongly supports regulators having adequate arrangements in place to continue to examine the changes to market structure and to identify emerging issues in a timely fashion. The letter notes, however, that ICI is concerned about the breadth of the statement in the Consultation that a review by regulators of developments in this area could lead to a reduction of dark liquidity.

Ari Burstein  
Senior Counsel - Securities Regulation

[Attachment](#)

---

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.