MEMO# 24361

June 14, 2010

ICI Submission for SEC Market Structure Roundtable

[24361]

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TO: SEC RULES MEMBERS No. 52-10
EQUITY MARKETS ADVISORY COMMITTEE No. 21-10
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 15-10
ETF ADVISORY COMMITTEE No. 23-10
CLOSED-END INVESTMENT COMPANY MEMBERS No. 29-10 RE: ICI SUBMISSION FOR SEC MARKET STRUCTURE ROUNDTABLE

The Institute has filed the attached submission with the Securities and Exchange Commission to address issues raised by the SEC's June 2, 2010 roundtable regarding the current U.S. equity market structure. The roundtable focused on issues raised in the SEC's recent concept release requesting comment on several market structure issues, including market structure performance, high frequency trading and undisplayed liquidity. [1] The letter reiterates several of the comments made in the Institute's letter on the concept release [2] and expresses the Institute's initial views on some of the market structure issues raised by the market events of May 6, 2010. The letter notes that the issues considered by the concept release and discussed at the roundtable have taken on increased importance given the events that occurred on May 6 as it is clear that these events were, at least in part, the result of inefficiencies in the current U.S. market structure.

I. Market Structure Issues Addressed in SEC Market Structure Concept Release

The letter reiterates the need for increased transparency regarding specific trading issues such as the order routing and execution practices of broker-dealers and other trading venues, as well as about broader market issues such as high frequency trading ("HFT") and undisplayed liquidity. The letter notes that as the events of May 6 illustrated, sufficient information about a growing portion of trading in the securities markets is lacking and that improved information about current trading practices and market participants would allow investors to make better informed investment decisions.

The letter also discusses the role of liquidity providers under the current market structure, particularly the increased presence of high frequency traders in the marketplace, and the effect their activities may have on the markets. The letter notes that the role of HFT and traditional liquidity providers such as market makers has taken on more significance since the events of May 6, as the sudden absence of liquidity in the markets played a critical role in the severe decline in stock prices. The letter recommends that the SEC examine the trading activity of HFT firms, the liquidity they provide, and consider whether HFT firms should be subjected to obligations similar to that of traditional market makers. The letter also recommends that the SEC examine whether more stringent obligations are necessary for traditional market makers in times of market stress.

Finally, the letter notes that much of the current debate over the structure of the U.S. securities markets has centered on the proliferation of undisplayed, or “dark,” liquidity. The letter states that funds have long been significant users of undisplayed liquidity and the trading venues that provide such liquidity. At the same time, it recognizes that while venues providing undisplayed liquidity bring certain benefits to funds, not displaying orders detracts to some extent from market transparency. The letter therefore supports the SEC’s efforts to examine the impact of certain undisplayed liquidity on price discovery in the markets, while balancing the competing goal of protecting fund shareholders from the effects of information leakage.

II. Market Structure Issues Arising from May 6, 2010 Market Events

The letter notes that the events of May 6 highlight the need to examine several other areas not specifically addressed in the SEC’s concept release. These include the need for: (1) updated market-wide and stock-by-stock circuit breakers; (2) better procedures for resolving clearly erroneous trades; (3) an examination of the use of market orders; (4) an examination of the inconsistent practices of exchanges regarding addressing major price movements in stocks; and (5) better coordination across all types of markets. The letter discusses the importance of these issues for all exchange-traded securities, including exchange-traded funds (“ETFs”). The letter notes that ETF trades comprised a majority of the trades that were cancelled on May 6 and that the large number of ETF trades that were cancelled was, at least in part, the result of inefficiencies in the current U.S. market structure.

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Attachment

endnotes

[1] See SEC Release No. 61358 (January 14, 2010), 75 FR 3594 (January 21, 2010) (Concept Release on Equity Market Structure), available at http://www.sec.gov/rules/concept/2010/34-61358.pdf.

[2] See Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated April 21, 2010.