MEMO# 24142

February 22, 2010

ICI Comment Letter on SEC Proposal Relating to Dark Pools and Other Non-Public Trading Interest

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 6-10
SEC RULES MEMBERS No. 19-10
CLOSED-END INVESTMENT COMPANY MEMBERS No. 13-10
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 4-10
ETF ADVISORY COMMITTEE No. 7-10 RE: ICI COMMENT LETTER ON SEC PROPOSAL RELATING TO DARK POOLS AND OTHER NON-PUBLIC TRADING INTEREST

The Institute has filed the attached comment letter on the SEC's proposal relating to dark pools and other non-public trading interest. The letter generally supports the proposal but recommends certain changes to prevent unintended consequences for funds.

I. Broad Examination of Market Structure Issues

The letter discusses the need for a broad examination of market structure issues and the SEC's concept release examining the current U.S. equity market structure. The letter notes that while the current proposal only addresses concerns relating to the transparency of non-public trading interest, it is important that any specific market structure issue not be viewed in a vacuum and that the SEC address the many diverse methods that investors use to trade. The letter also highlights several issues that the Institute plans to address in its comment letter on the concept release including the need for an examination of the information provided by executing brokers and trading venues to investors; internalization; incentives to direct order flow; better enforcement and surveillance of the securities markets; and fragmentation.

II. Post-Trade Transparency for Dark Pools and Other ATSs

The proposal would require the real-time disclosure of the identity of individual dark pools and alternative trading systems ("ATSs") on trade reports in the public data stream. The letter generally supports increasing post-trade transparency for ATSs. The letter, however, provides several recommendations to amend the proposal to prevent unintended consequences for funds. Most significantly, the letter opposes the real-time disclosure of individual ATS identities as it would leave too large a "footprint" of fund orders and has the potential to facilitate the frontrunning of funds' portfolio holdings. While the letter does not support the real-time disclosure of the identity of an individual ATS, the letter supports such disclosure on a delayed basis. Specifically, the letter recommends that the SEC require the disclosure of the identity of individual ATSs on trade reports at the end of the trading day, on a stock-by-stock basis. The letter states that it is the general consensus of Institute members that this disclosure should apply uniformly across all types of stocks but that several members remain concerned that end-of-day disclosure for certain less liquid stocks, such as small-cap and mid-cap stocks, could still lead to frontrunning of mutual fund trades. The letter therefore states that the Institute would not object to a bifurcated disclosure model where trades in large-cap, liquid stocks would be required to be disclosed at the end of the day and trades in smaller, less liquid stocks would be required to be disclosed on a further delayed basis (e.g., T+5).

III. Actionable IOIs and ATS Display Obligations

The proposal would address pre-trade transparency in ATSs by applying the definition of "bid" or "offer" to "actionable IOIs" privately transmitted by dark pools and other trading venues to selected market participants. The proposal also would lower the trading volume threshold in Regulation ATS, from 5% to 0.25%, that triggers the order display and execution access requirements for an ATS. The letter generally supports the pre-trade transparency proposals. The letter states that while many trading venues may use actionable IOIs to find contra-side trading interest for large size orders, funds do not typically permit their orders to be advertised via actionable IOIs due to concerns relating to frontrunning. Therefore, the benefits of pre-trade transparency outweigh any impact (limited as it might be) on fund trading. The letter also urges the SEC to examine any unintended consequences that may arise as a result of the new requirements prior to any decision whether to adopt the proposals.

IV. Exception for Institutional Sized Trades and Quotes

The proposals contain an exemption from the pre-trade and post-trade requirements for large sized trades or quotes, i.e., trades and quotes with a value of at least $200,000. The letter states that the exemption would not include certain large-sized orders in small-cap and mid-cap stocks that would raise the same concerns about the frontrunning of orders and information leakage as exempted orders. The letter therefore recommends that the exemption be modified to include a threshold based not only on the dollar value of a trade, but also on a variety of other factors, e.g., the lesser of a dollar value of a trade, the number of shares of a trade, or the percentage of the average daily volume of a stock that a trade represents.

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Attachment (in .pdf format)
