MEMO# 11894

May 19, 2000

INSTITUTE COMMENT LETTER ON SEC CONCEPT RELEASE REGARDING MARKET FRAGMENTATION

* Securities Exchange Act Release No. 42450 (February 23, 2000), 65 FR 10577 (February 28, 2000). [11894] May 19, 2000 TO: BOARD OF GOVERNORS No. 27-00 EQUITY MARKETS ADVISORY COMMITTEE No. 32-00 SEC RULES COMMITTEE No. 76-00 RE: INSTITUTE COMMENT LETTER ON SEC CONCEPT RELEASE REGARDING MARKET FRAGMENTATION ____ The Institute has filed a comment letter (attached) with the Securities and Exchange Commission in connection with the SEC's concept release regarding market fragmentation.* The comment letter first addresses the Institute's concerns with current market structures, in particular those that have contributed to fragmentation. The letter states that fragmentation arises from many factors, including internalization, the lack of priority rules across markets, inadequate market linkages, and the lack of transparency and depth of book in the securities markets. The letter then discusses the Institute's recommendations to address these concerns. In particular, the letter states that in the long term, the best way to rectify the shortcomings in the securities markets would be for the SEC to mandate price/time priority across all markets. The comment letter states, however, that such a price/time priority system will only prove feasible once certain conditions are in place, which include the development of systems that allow market participants to efficiently route orders to different markets on a price/time priority basis and the establishment of standards relating to the execution of orders for participating markets. Because these conditions may take some time to be developed and implemented, the letter states that the SEC should, in the interim, require all market centers to display a minimum amount of their limit order book, adopt a price improvement requirement for internalized orders, and require price/time priority on an intramarket basis. Finally, the comment letter responds to several objections that have been raised regarding a system mandating price/time priority. For example, the letter states that arguments have been put forth that a price/time priority system removes incentives for intermarket competition on factors other than price. The Institute believes, however, that there will still be a variety of ways in which markets can, and will, seek to distinguish themselves from other market centers, e.g., through reliability, anonymity, reserve book features, and cost of execution. Ari Burstein Assistant Counsel Attachment