MEMO# 17409

April 22, 2004

INSTITUTE TESTIFIES AT SEC REGULATION NMS HEARING

[17409] April 22, 2004 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 19-04 SEC RULES MEMBERS No. 59-04 RE: INSTITUTE TESTIFIES AT SEC REGULATION NMS HEARING On April 21, John Wheeler, Vice President and Director of U.S. Equity Trading at American Century Investments, testified on behalf of the Institute at a hearing held by the Securities and Exchange Commission on proposed Regulation NMS. A copy of Mr. Wheeler's oral statement is attached and the most significant aspects of the statement are summarized below. Mr. Wheeler began by commending the SEC for issuing proposed Regulation NMS and noting that the Institute has strongly supported past regulatory efforts to improve the quality of the U.S. securities markets. He stated that the structure of the securities markets has a significant impact on the Institute's mutual fund members as increased efficiencies will clearly benefit mutual fund shareholders. Mr. Wheeler testified that despite all the recent changes to the securities markets, they still do not facilitate efficient trading by mutual funds. In order to create the optimal market structure for investors, Mr. Wheeler stated, the SEC should focus its efforts on promoting the key principles of a national market system, specifically, efficiency, competition, price transparency, and the direct interaction of investor orders. He added that in order to provide investors with the incentive to publicly display their orders and to create a market structure in which these orders can effectively interact, the market structure should contain several key components, i.e., price and time priority for displayed limit orders across all markets, strong linkages between markets that permit easy access to limit orders and standards relating to the execution of orders. Regarding Regulation NMS' trade-through proposal, Mr. Wheeler stated that the Institute supports the establishment of a uniform trade-through rule for all market centers as well as the proposed exception to the trade-through rule that would permit an "automated" market to trade through a better priced displayed bid or offer on a "non-automated" market. In addition, while the Institute supports the distinction between an "automated" and "non-automated" market, it believes that the SEC should provide a stronger definition of what constitutes an "automated" market. 2 Mr. Wheeler indicated that, if the SEC strengthens its definition of an "automated" market in the manner recommended by the Institute and creates strong linkages and access between automated markets, the proposal's other exception, allowing an "informed investor" to "opt-out" of the trade-through rule, may be unnecessary. He explained that this is because an ideal market structure should not provide the ability for any market participant to ignore better priced orders in the market. Mr. Wheeler added that the exception also is inconsistent with the principle of price protection for limit orders and that the Institute is concerned that the exception could discourage the placement of limit orders if investors know that those orders can be ignored. Finally, Mr. Wheeler stated that if the SEC does not adopt a stronger definition of an "automated" market and permits disparities to remain in the ability to execute orders

between “automated” markets under proposed Regulation NMS, the inefficiencies investors are experiencing in the markets today could remain. Therefore, under those circumstances, in order to allow investors to avoid having their orders routed to an inefficient market, the “opt- out” exception may be necessary. Ari Burstein Associate Counsel Attachment (in .pdf format) Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (http://members.ici.org) and search for memo 17409, or call the ICI Library at (202) 326-8304 and request the attachment for memo 17409.
