

COMMENT LETTER

January 26, 1999

Comment Letter on NASD's Optimark Proposal, January 1999

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Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: File No. SR-NASD-98-85

Dear Mr. Katz:

The Investment Company Institute¹ appreciates the opportunity to comment on the proposed rule change filed by the National Association of Securities Dealers ("NASD") to establish the Nasdaq Application, a new electronic trading system based on the information processing technology provided by Optimark Technologies, Inc. and its wholly owned subsidiary, Optimark Services, Inc. ("Optimark").² The Institute strongly supports the proposed rule change.

The Nasdaq Application is a computerized, screen-based trading system intended for use by NASD members and other nonmember users. The Nasdaq Application, which will be operated as a new, additional facility of the Nasdaq Stock Market ("Nasdaq"), will enable users to anonymously submit customized expressions of interest called "profiles," indicating their trading interest in securities listed on Nasdaq in many different prices and sizes. The Nasdaq Application then will match these profiles, utilizing the user's level of satisfaction of trading at the various prices and sizes submitted in the profile.

The Institute believes that investors, both institutional and retail, will benefit from the adoption of the proposed rule change. The Nasdaq Application would increase transparency and facilitate best execution in securities traded on Nasdaq. The Nasdaq Application also would increase liquidity, reduce trading costs, and increase the efficiency of the Nasdaq market overall.

As the Proposing Release notes, one trading service based on the Optimark technology already has been approved by the SEC for operation on the Pacific Exchange.³ The OptiMark technology used in the Nasdaq Application is virtually identical to that which has already been approved for the PCX Application. The Institute supported the PCX Application,

as well as the proposal to amend the Intermarket Trading System ("ITS") to link the PCX Application of the Optimark system to the ITS system.[4](#)

The Institute's specific comments on the proposed rule change follow.

Anonymity

Under the proposed rule change, profiles entered into the Nasdaq Application will not be disclosed to other users or market participants, including any "designated broker."[5](#) through which a nonmember user will submit profiles and obtain executions. The Institute believes that the anonymity feature of the Optimark technology used in the Nasdaq Application is a significant aspect of the system. Anonymity and confidentiality minimize the market impact of large orders, which is a concern to institutional investors such as investment companies. If institutional investors were required to reveal their identity upon submitting a profile to the Nasdaq Application, they would be forced to reveal information concerning their specific trading strategies. This, in turn, may drive institutional investors to minimize the number of orders entered into the system and to instead send orders "upstairs" to be executed by traditional brokers, reducing overall transparency and liquidity in the market.

Liquidity

According to the proposed rule change, in addition to profiles submitted directly by users of the Nasdaq Application, the Nasdaq Application will include certain system-generated profiles, known as "Nasdaq Quote Montage Profiles," which reflect the national best bid and offer quotes from Nasdaq market makers, ECNs, and UTP Exchange Plan Specialists as displayed in the Nasdaq Quote Montage at the time a matching "cycle" begins. The Nasdaq Application therefore will include expressions of interests of all system users in addition to the publicly displayed quotes comprising the national best bid and offer. The Institute believes that this feature will facilitate best execution in securities traded on Nasdaq and increase liquidity in the Nasdaq market overall.

Access to the Nasdaq Application

Under the proposed rule change, the Nasdaq Application would be available to any NASD member that chooses to become a user and complies with all applicable rules. In addition, a nonmember could become a user if authorized in advance by one or more NASD members who are designated brokers. The profiles of the nonmember user would be executed, cleared, and settled through the use of the designated broker's name within the Nasdaq Application. The designated broker also would be responsible for all of its nonmember users' orders and resulting transactions. The Institute supports this provision of the proposed rule change. Providing access to nonmember users would provide more investors with greater access to the market and allow them to execute against the priced orders in the system, thereby enhancing the ability of investors to efficiently trade on the Nasdaq market.

National Market System

The Institute believes that the Nasdaq Application would further the development of the national market system ("NMS") as well as the purposes of Section 11A of the Securities

Exchange Act of 1934. As noted in the SEC's release, the Nasdaq Application takes advantage of new data processing and communications techniques to create the opportunity for a more efficient market in the trading of Nasdaq securities. In particular, the Nasdaq Application would promote the efficient execution of securities transactions, fair competition among markets, and the best execution of customer orders. As the importance of the availability of reliable and efficient trading systems increases, the Institute believes that the Nasdaq Application will help meet the complex needs of institutional investors.

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The Institute appreciates the opportunity to comment on this proposal. Any questions regarding our comments may be directed to the undersigned at (202) 371-5408.

Sincerely,

Ari Burstein
Assistant Counsel

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,390- open-end investment companies ("mutual funds"), 450 closed-end investment companies, and 9 sponsors of unit investment trusts. Its mutual fund members have assets of about \$5.306 trillion, accounting for approximately 95% of total industry assets, and have over 62 million individual shareholders.

2 Securities Exchange Act Release No. 40835 (December 28, 1998), 64 FR 549 (January 5, 1999).

3 See Securities Exchange Act Release No. 39086 (September 17, 1997), 62 FR 50036 (September 24, 1997).

4 Securities Exchange Act Release No. 40204 (July 15, 1998), 63 FR 39306 (July 22, 1998). See Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated September 2, 1998 (File No. 4-208).

5 "Designated broker" is defined in the proposal as an NASD member who has been designated by a nonmember user to execute, clear, and settle transactions resulting from the Nasdaq Application.