

COMMENT LETTER

January 3, 2011

ICI Letter on CFTC Request for Comment on Anti-Disruptive Trading Practices Authority Contained in Dodd-Frank Act (pdf)

January 3, 2011 Mr. David A. Stawick Secretary Commodity Futures Trading Commission
Three Lafayette Centre 1155 21st Street, N.W. Washington, D.C. 20581 Re: Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act (RIN No. 3038-AD26) Dear Mr. Stawick: The Investment Company Institute¹ is writing to provide comments on the Commodity Futures Trading Commission's ("Commission") advance notice of proposed rulemaking ("ANPR") regarding the authority provided to the Commission under Section 747 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").² Section 747 amends the Commodity Exchange Act to prohibit certain trading practices deemed disruptive of fair and equitable trading.³ Need for Clarity as to Prohibited Trading Practices The Institute supports the Commission's examination of the issues surrounding the authority provided by Section 747 as it is critical that the rules governing the financial markets keep pace with the significant changes in the trading practices used by market participants. In past comments on proposals to reform the rules overseeing the financial markets, the Institute has recommended that regulators

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.31 trillion and serve over 90 million shareholders.

² Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act, RIN No. 3038-AD26 (October 26, 2010), 75 FR 67301 (November 2, 2010).

³ Specifically, Section 747 makes it unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that: (A) violates bids or offers; (B) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or (C) is, is of the character of, or is commonly known to the trade as "spoofing" (bidding or offering with the intent to cancel the bid or offer before execution).

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examine whether any new regulations are necessary to address certain trading strategies that should be considered as improper or manipulative activity.⁴ Recent technological advances in trading have allowed these trading strategies to be employed more easily and cheaply, thereby lowering the risk to users of these strategies. This, in turn, has made trading more

challenging for funds that are interested in buying and selling large positions and that can be disadvantaged by market participants that trade in front of their orders. At the same time, the series of questions raised in the ANPR highlight the complexities of the trading practices that are the subject of Section 747 and the need for clarity as to the nature of the conduct that is prohibited under the section. We therefore recommend that in any future proposal implementing Section 747, the Commission provide additional guidance as to the types of conduct that would constitute violations under the statute. Market participants that seek to abide by the law need and deserve clarity as to the line between permitted practices and those carrying the very serious charge of being “unlawful” and “disruptive to fair and equitable trading.” Moreover, as new practices develop, guiding principles will be necessary to determine the regulatory consequences of those practices. For example, Section 747 does not define several of the key terms used in delineating prohibited activities including “violates bids or offers,” “the orderly execution of transactions,” or “spoofing.” In addition, because of the varied trading practices used by market participants, it may be difficult to distinguish between legitimate and disruptive trading practices in a number of situations, e.g., trading activity during the “closing period.” The use of algorithms and automated trading systems has become important for funds in the normal course of the routing and execution of orders. The Institute wants to ensure that any rulemaking surrounding trading does not create unintended consequences for funds or impede the use of legitimate trading practices. Clarity as to the prohibited conduct under the statute would go far to accomplishing this goal. “Spoofing” and the Cancellation of Orders While the ANPR requests comment on a number of trading practices, the Release asks several questions regarding the practice of “spoofing.” For example, the Release requests comment whether the Commission should separately specify and prohibit certain practices as distinct from “spoofing” or whether these practices should be considered a form of “spoofing” prohibited under the statute including (1) submitting or cancelling bids or offers to overload the quotation system of a registered entity, or delay another person’s execution of trades; (2) submitting or cancelling multiple bids or offers to cause a material price movement; and (3) submitting or cancelling multiple bids or offers to create an appearance of market depth that is false. 4 See, e.g., Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated April 21, 2010. Mr. David A. Stawick January 3, 2011 Page 3 of 3 The Institute strongly supports actions by the Commission to address issues surrounding the increasing number of order cancellations in the markets, particularly when numerous orders are cancelled shortly after submission. Our members report that certain of the practices and strategies surrounding cancellations often are designed to detect the trading of large blocks of securities by funds and to trade with or ahead of those blocks. * * * We offer our assistance to the Commission as it continues to examine the issues raised by the ANPR and their impact on the markets. If you have any questions on our comment letter, please feel free to contact me directly at (202) 326-5815, or Ari Burstein at (202) 371-5408. Sincerely, /s/ Karrie McMillan Karrie McMillan General Counsel cc: The Honorable Gary Gensler, Chairman The Honorable Michael Dunn, Commissioner The Honorable Bart Chilton, Commissioner The Honorable Jill E. Sommers, Commissioner The Honorable Scott D. O’Malia, Commissioner