

COMMENT LETTER

May 21, 2009

ICI Comment Letter: IOSCO Consultation Report on "Direct Electronic Access" Arrangements

May 20, 2009 Mr. Greg Tanzer Secretary General IOSCO C / Oquendo 12 28006 Madrid Spain Re: Public Comment on Policies on Direct Electronic Access Dear Mr. Tanzer: The Investment Company Institute¹ welcomes the opportunity to comment on the IOSCO consultation report on direct electronic access ("Consultation Report").² Institute members are significant investors in the global securities markets.³ Efficient access to the markets is therefore critical to Institute members. To achieve the most efficient access, mutual funds often enter into direct electronic access ("DEA") arrangements. DEA arrangements provide investors with greater control over their trading decisions, can reduce execution times, and are a means to provide confidentiality to information about trades. For these reasons, Institute members have a keen interest in the principles issued by IOSCO regarding DEA arrangements. We appreciate that IOSCO recognizes the importance of direct electronic access, and we support IOSCO's effort to issue principles aimed at protecting the integrity of financial markets. The Institute has been examining several issues relating to direct electronic access in conjunction with

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 \$9.71 trillion and serve over 93 million shareholders. 2 IOSCO Consultation Report: Policies on Direct Electronic Access (February 2009). The Consultation Report can be found on IOSCO's website at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD284.pdf>. 3 As of year-end 2008, registered investment companies held 27% of outstanding U.S. issued stock, 44% of outstanding commercial paper, 33% of tax-exempt debt, 9% of U.S. corporate bonds and 15% of U.S. Treasury and government agency debt. See 2009 Investment Company Fact Book, 49th Edition, p. 11-12. In addition, according to ICI data, mutual funds and ETFs held approximately \$1.1 trillion of foreign stocks and bonds at year-end 2008. Mr. Greg Tanzer May 20, 2009 Page 2 of 4 proposals in the U.S. to reform the regulation of DEA arrangements. For example, earlier this year, the NASDAQ Stock Market ("Nasdaq") filed with the U.S. Securities and Exchange Commission ("SEC") a proposed rule change to modify the requirements for Nasdaq members that provide DEA to Nasdaq's execution system.⁴ Nasdaq's proposed rules are intended to address concerns regarding oversight and risk management of DEA arrangements and, if adopted, are expected to serve as a model for regulations to be imposed by other U.S. securities exchanges. In examining the

Nasdaq proposal, the Institute identified certain issues that could have unintended consequences for funds and other institutional investors. Many of these issues are applicable to certain of the principles delineated in the Consultation Report. As IOSCO further considers its principles on DEA arrangements, we urge it to consider these issues, which are discussed in further detail below. Confidentiality of Investor Trading Information Should be Protected We recognize the need for regulators and intermediaries to monitor orders and utilize information about trades to prevent market manipulation and abuse. In crafting regulations concerning DEA arrangements, however, regulators must be careful to protect the confidentiality of fund trading information. The confidentiality of this information is a critical issue to Institute members. Any leakage of this information can lead to frontrunning of a fund's trades, adversely impacting the price of the stock that the fund is buying or selling to the detriment of its shareholders.⁵ The Consultation Report contains several principles that raise concerns in this area. For example, the Consultation Report states that (1) markets should provide member firms with access to all pre- and post-trade information (on a real time basis) to enable these firms to implement appropriate monitoring and risk management controls, and (2) intermediaries should disclose to market authorities upon request and in a timely manner the identity of their DEA customers in order to facilitate market surveillance. The Institute believes that information regarding an investor's orders and trades that is disclosed must be limited to information that is relevant to specific risk concerns created by the particular DEA arrangement. Information that is not relevant to the DEA arrangement would not enhance the monitoring and risk management of these arrangements and could expose an investor's trading information to potential misuse. The scope and details of information that would be disclosed under the Consultation Report's principles is unclear. 4

Securities Exchange Act Release No. 59275 (January 22, 2009), 74 FR 5193 (January 29, 2009). The Nasdaq proposal is available on the SEC's website at <http://www.sec.gov/rules/sro/nasdaq/2009/34-59275.pdf>. 5 The Institute has made this point to the SEC on several occasions. See Letters from Paul Schott Stevens, President and Chief Executive Officer, Investment Company Institute, to Christopher Cox, Chairman, Securities and Exchange Commission, dated September 14, 2005, August 29, 2006, and September 19, 2008. Mr. Greg Tanzer May 20, 2009 Page 3 of 4 In the U.S., the Nasdaq proposal would require agreements between the "sponsoring member" and "sponsored participant"⁶ to contain certain contractual provisions, including that the sponsored participant would provide the sponsoring member with access to its books and records as well as complete and current corporate and financial information. We oppose these provisions as they do not limit the information provided to that which is relevant to the DEA arrangement and would expose funds to the risk of disclosure of sensitive information. We urge other regulators to refrain from imposing such provisions. In order to mitigate the risks that arise when an investor shares information with an intermediary, we recommend that DEA regulations contain meaningful and enforceable confidentiality safeguards applicable to both intermediaries and any other recipients of the data (e.g., exchanges). These safeguards should, at a minimum, require the recipients of the information to maintain the confidentiality of the information and to use it exclusively for regulatory purposes. Regulations Should Provide Flexibility to DEA Arrangements Numerous methods of direct electronic access exist and operate differently from one another. In adopting and implementing DEA regulations, we urge regulators to not take a "one size fits all" approach to the regulation of DEA arrangements. Instead, consideration should be given to factors such as the type of investor using the arrangement, the specific methods of DEA, and existing rules and regulations. Failure to give appropriate consideration to these factors could result in regulations that are unnecessary, burdensome and inflexible. Such regulations also could limit the ability of intermediaries to provide efficient and competitive

DEA services to investors. Impact of Requirements on Sponsoring Intermediaries and Exchanges Should be Considered Prior to adopting any new or amended regulations regarding DEA arrangements on sponsoring intermediaries and exchanges, regulators should carefully consider any potential unintended consequences of the impact of these regulations on the end-user, the investor. For example, if these regulations are too onerous or costly for certain intermediaries, they may determine to not offer DEA arrangements, thereby reducing the number of available trading venues for investors and potentially negatively impacting best execution. Similarly, the cost of trading may be increased as intermediaries shift the burden of compliance with the requirements onto investors. We believe that providing intermediaries with flexibility to utilize existing risk management controls that they determine are the most effective should be considered and may best serve the interests of the securities market and investors. * * * * *

6 "Sponsoring member" and "sponsoring participant" are defined terms under the Nasdaq proposal. Mr. Greg Tanzer May 20, 2009 Page 4 of 4 We appreciate the opportunity to express our views on the Consultation Report and look forward to working with IOSCO as it continues to examine these issues. In the meantime, if you have any questions, please feel free to contact me directly at (202) 371-5408 or Eva Mykolenko at (202) 326- 5837. Sincerely, /s/ Ari Burstein Ari Burstein Senior Counsel cc: James Brigagliano, Acting Co-Director Dan Gallagher, Acting Co-Director Division of Trading and Markets U.S. Securities and Exchange Commission Richard G. Ketchum Chairman & Chief Executive Officer FINRA