INVESTMENT COMPANY INSTITUTE

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May 11, 2015

Mr. Brent Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: *SEC Equity Market Structure Advisory Committee (File No. 265-29)*

Dear Mr. Fields:

The Investment Company Institute[1] is writing to provide its views on the issues to be discussed at the May 13, 2015 meeting of the SEC Equity Market Structure Advisory Committee, particularly Rule 611 of Regulation NMS – the so-called "trade through rule." ICI members have a significant interest in ensuring that the regulatory structure that governs the equity markets allows for the most orderly, efficient and competitive markets possible. Consistent with this goal, we support the examination of issues surrounding Rule 611, and Regulation NMS in general, which may impact the operation of the equity markets and investor confidence in those markets. As discussed further below, we also strongly recommend that the SEC promptly address related market structure issues, such as conflicts of interest created by liquidity rebates and access fees, which are equally, if not more important, to ensuring an efficient market structure for investors.

It is clear that the debate over Regulation NMS will be lengthy. We therefore offer our assistance to the SEC and the Advisory Committee as they consider whether Rule 611 should be rescinded or modified, as well as other issues related to the structure of the equity markets.

[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $17.9 trillion and serve more than 90 million U.S. shareholders.

I. Trade Through Rule

Regulation NMS was designed to address a variety of challenges facing the U.S. securities markets a decade ago that generally fell within three categories: (1) the need for uniform rules that promote the equal regulation of, and free competition among, all types of market centers; (2) the need to update antiquated rules that no longer reflect current market conditions; and (3) the need to promote greater order interaction and displayed depth, particularly for the very large orders of institutional investors.

There is no doubt that in the years since Regulation NMS' adoption, the equity markets have changed dramatically. Nevertheless, in many respects, investors are still facing trading challenges similar to those described above. Significantly, the third category above, promoting greater order interaction and displayed depth, continues to be of great importance to funds.

It is for this reason that when Regulation NMS was proposed, ICI supported the establishment of a uniform trade through rule for all market centers.[2] By affirming the principle of price priority, we believed a trade through rule would encourage the display of limit orders, which in turn would improve the price discovery process and contribute to increased market depth and liquidity. We also believed that a trade through rule would increase investor confidence in the equity markets by helping to eliminate an impression of unfairness when an investor's order executes at a price worse than the displayed quote.

ICI continues to support a trade through rule for the equity markets. We recognize that since its adoption, Rule 611 may not have achieved all of its objectives, particularly rewarding the display of limit orders by increasing their likelihood of execution. In addition, as the recent SEC staff memo to the Advisory Committee on Rule 611 notes,[3] the complete impact of the trade through rule on the equity markets is unclear, particularly as it relates to market fragmentation, trading volume and trade sizes. Nevertheless, we do not see the benefit to investors, and the equity markets in general, of eliminating the trade through rule and permitting the execution of trades on one venue at prices that are inferior to publicly displayed quotations on another venue.

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[2] *See* Letter from Ari Burstein, Associate Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated June 30, 2004; available at http://www.ici.org/policy/markets/domestic/04_sec_nms_com. *See also* Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated April 21, 2010; available at http://www.ici.org/pdf/24266.pdf (SEC Concept Release on Equity Market Structure).

[3] Memorandum from SEC Division of Trading and Markets to SEC Market Structure Advisory Committee, dated April 30, 2015 ("SEC Rule 611 Memo").

We also do not agree with some of the criticisms placed on Rule 611 as noted in the SEC Rule 611 Memo. Significantly, we do not agree that the trade through rule alone has harmed institutional investors that need to trade in large size by forcing them to access small-sized quotations and thereby signal their trading intentions to short-term proprietary traders. The confidentiality of information regarding orders is arguably the most significant consideration for funds when trading. Any premature or improper disclosure 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. We believe, however, that a number of market structure developments since Rule 611's adoption, such as advancements in the use of algorithms, more efficient order routing technology, and the proliferation of trading venues have contributed to institutional investors accessing small-sized quotes. Placing the blame on the trade through rule alone would be unfair.

While we continue to support a trade through rule, given the significant changes to the structure of the equity markets since the rule was adopted, we do believe that certain modifications may be warranted or, at the very least, worthy of examination. For example, some have suggested that current practices have reduced the need for regulatory protections of smaller venues under the trade through rule. Specifically, proposals have been set forth to revise Regulation NMS so that, until an exchange or other currently-protected market center achieves a certain market share (*e.g.,* greater than one percent share of CADV in any rolling three-month period), they should no longer be protected under the trade-through rule.[4] ICI would support linking protected quotation status to a certain volume threshold.

II. Addressing Conflicts of Interest in the Markets – Liquidity Rebates and Access Fees

The issues surrounding Rule 611 cannot be viewed in a vacuum. As the SEC and the Advisory Committee examine the issues surrounding Rule 611, we believe it is important not to overlook a number of other related market structure issues that impact investor trading that are equally, if not more, important as addressing the trade through rule. Specifically, any changes to the trade through rule must be looked at in the context of conflicts of interest that exist in the markets when orders are routed, particularly those surrounding liquidity rebates and access fees.

The SEC recognized the linkage between order routing and liquidity rebates and access fees when it proposed Regulation NMS and considered a variety of proposals to address these issues. Ultimately, the SEC limited access fees such that they could not be more than a *de minimis* amount.[5] While Regulation NMS capped access fees, it did not eliminate or limit liquidity rebates. If anything,

[4] *See, e.g.,* BATS Global Markets, Petition for SEC Rule-Making, dated January 21, 2015.

[5] In particular, Rule 610 of Regulation NMS limits the fees that can be charged for access to quotations to $0.003 per share (or 0.3 percent of the quotation price per share for quotations less than $1.00).

the practice of providing liquidity rebates has become more pronounced since the adoption of Regulation NMS.

ICI believes that to adequately address some of the concerns surrounding the impact of the trade through rule, such as market fragmentation, the lack of order flow to the "lit" markets, and reduced average trade size, the SEC would be well served to promptly address issues surrounding liquidity rebates and access fees. If the current incentives for making routing decisions based on the availability and amount of liquidity rebates offered, and access fees charged, by trading venues are reduced or eliminated, we believe a number of benefits to the markets would be brought to bear. For example, the distortions in order routing decisions and execution strategy based on capturing rebates or the avoidance of access fees would be reduced. In addition, fragmentation may decrease as there would be less incentive for certain "dark" venues to exist if rebate capture or access fee avoidance is addressed. In turn, less fragmentation may result in more order flow to the "lit" markets.

ICI previously recommended that the SEC institute a pilot program to generate data in the area of liquidity rebates. We firmly believe that more must be learned about the effects of this practice on investors and the markets. We therefore continue to recommend that the SEC work with market participants to establish a pilot program where a certain set of securities would be prohibited from being subject to liquidity rebates. In this manner, the SEC can examine the data generated about liquidity rebate practices and determine whether rulemaking is necessary to address concerns in this area. We also would support a corresponding examination of, and reduction in, access fees.

III. Locked and Crossed Markets

We understand that in the context of examining Regulation NMS, some have suggested that rules prohibiting locked and crossed markets should be eliminated. At this time, ICI continues to support rules that reduce the incidence of locked and crossed markets. We believe locked and crossed markets can have a negative impact on the securities markets and can be a sign of an inefficient market structure. In addition, locked and crossed markets may create confusion for investors, as the true trading interest in a stock is unclear under such circumstances.

We also believe many incidences of locked and crossed markets can be attributed to the proliferation of access fees and liquidity rebates. If the SEC were to address the issues surrounding access fees and rebates, as discussed above, we believe many of the issues relating to locked and crossed markets would be eliminated, and an elimination of the prohibition on locked and crossed markets can be revisited.

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If you have any questions on our comment letter, please feel free to contact me directly at [redacted] or at [redacted].

Sincerely,

/s/ Ari Burstein

Ari Burstein
Associate General Counsel

cc: The Honorable Mary Jo White, Chair
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner

Stephen Luparello, Director, Division of Trading and Markets
Gary Goldsholle, Deputy Director, Division of Trading and Markets
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