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October 23, 2012

Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: *SEC Technology and Trading Roundtable (File No. 4-652)*

Dear Ms. Murphy:

The Investment Company Institute<sup>1</sup> is writing to respond to the issues raised by the Securities and Exchange Commission's ("SEC") recent roundtable on technology and trading ("Roundtable"). ICI members and their shareholders have a significant interest in ensuring that the regulatory structure that governs the financial markets allows for the most effective system possible to address risks posed by technological developments in trading. Consistent with this goal, we strongly support the examination of issues that may impact the fair and orderly operation of the financial markets and investor confidence in those markets, and the dialogue initiated by the SEC through the Roundtable on these issues.

The issues surrounding technology and trading are complex and worthy of lengthy consideration before any determinations are made as to the implementation of new risk management procedures. Several of the recommendations already set forth by various market participants to address market risk require significant vetting among ICI members to consider the potential issues raised by the recommendations, including any unintended consequences for investors, and any possible alternatives to the recommendations that might adequately address industry concerns. The comments provided in this letter therefore reflect ICI's preliminary and broad views on addressing the risks posed by technology and trading.

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<sup>1</sup> 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 \$13.5 trillion and serve over 90 million shareholders.

## **I. Need for Long-Term Investor Involvement in Discussions**

ICI and its members have not been privy to the discussions that have taken place in forming ideas on how to address risks posed by technology. There was no long-term investor representation at the Roundtable and the “industry working group” that provided comments in advance of the Roundtable, discussed further below, also did not include any long-term investors.

ICI believes that if decisions are going to be made regarding initiatives and proposals to address trading and technology, particularly those that may impact the tools used by funds when trading, long-term investors must be a part of that discussion. We offer our assistance, and the assistance of our members, going forward as these issues continue to be examined.

## **II. Need to Expand Discussion to Other Market Structure Issues**

ICI agrees that the need to examine specific risks posed by technology is significant. We also believe it is critical not to lose sight of the need to examine possible contributing factors to market infrastructure disruptions. The current market structure in the United States has evolved significantly, and consideration should be given to whether it has evolved in the best interests of investors.

ICI has on several occasions discussed the need to examine issues related to technology that, at the very least, questions whether certain developments have benefited investors. One such issue is the increasing amount and complexity of order types that exchanges and other trading venues continue to create to cater to market participants who create automated trading strategies and desire a vehicle through which to implement those strategies. Many of these order types facilitate strategies that can lead to disorderly markets or that can benefit market participants at the expense of long-term investors. We therefore recommend that these order types be vigorously examined as well as any risks to the markets raised by the use of these order types.

Another issue is the increasing number of order cancellations in the markets, particularly those that are cancelled shortly after submission. Orders sent to the market with no intention of being executed can strain a market’s technological infrastructure, and under the right circumstances, could interrupt the ability to process trades in an orderly fashion. ICI members also report that certain of the practices and strategies surrounding cancellations often are designed to detect fund trading of large blocks of securities and to trade with or ahead of those blocks to the detriment of investors.

Finally, we believe the complexity in the current structure of the markets attributable to the sheer number of execution venues that exist, and the toll that requiring connectivity to these venues can take on market participants, also needs to be examined as this also can add to the risks of increased market infrastructure disruption events.

These issues reflect just a few of the concerns that members report about the current structure of the markets. Unfortunately, it often is not in the best interests of sellside market participants, as well as many of those on the buy-side with purely short-term investing interests, to address these concerns. We request that future work on this issue involve the buy-side to ensure that all market participants' concerns and views are exchanged.

### **III. Addressing Market Risks from Technology**

The proliferation of technology has forced funds and other institutional investors to modify their trading strategies. Funds heavily utilize the new technology and tools available to them when trading; funds are therefore impacted by the risks posed by technology due to the actions by other market participants and the increased volume of trading in general attributable to electronic trading.

Recent market infrastructure disruptions have highlighted the need for mechanisms to address risks raised by the use of technology in trading. Clearly, it is in everyone's best interests to prevent errors, as well as examine the most efficient response to errors that occur. ICI has therefore supported efforts in this area, including the establishment of pre- and post-trade risk controls to prevent systems from generating and sending orders to the market that may be erroneous. We believe many of the steps already taken to address market risks have improved the ability of markets to respond to market disruption events (*e.g.*, steps taken after the flash crash and initiatives to address risks surrounding direct market access). We agree, however, that additional measures are necessary given that many market disruption events continue to occur.

As additional measures are examined, ICI believes that several basic principles should be considered. An intermediary or trading venue, as applicable, should have the ultimate responsibility for the orders sent to the market through its trading system and for the compliance of the orders with applicable regulatory requirements. This responsibility should include all aspects of the trading system including the design, development, deployment and operation of the system as well as the system's reliability, security and capacity. Similarly, we support requirements for an intermediary or trading venue to ensure that a trading system and all modifications to the system are adequately tested before deployment and are regularly reviewed to ensure that the system and modifications are reliable. We also believe control measures must be in place to prevent systems from generating and sending orders to the market that may be erroneous as well as effective controls to enable the cancellation of unexecuted orders in the markets.

### **IV. Industry Recommendations to Address Market Risk**

As noted above, there have been a number of recommendations already set forth to address the risks posed by technology and trading. For example, the industry working group established to examine technology and trading provided several recommendations to create supplemental controls to further

mitigate the risks associated with technological problems.<sup>2</sup> These include: (1) establishing “kill switches” through limits that track the “Peak Net Notional Exposure” for each firm that would allow limits to be placed on overall and/or categories of activity; (2) further study to develop other potential quantitative controls to better detect abnormal trading behavior in real-time; and (3) evaluating whether a longer-term consolidated control mechanism could be built at DTCC’s clearing agency subsidiaries. The working group also recommended additional measures with respect to the existing single stock circuit breakers, the limit up-limit down plan, and clearly erroneous execution rules.

Other proposals that have been put forth have suggested mandating the use of “drop copies” to assist in the reconciliation of trading records. In addition, just last week, CFTC Commissioner Chilton recommended several steps to address market risk including requiring firms to test trading programs before they are released into the markets, compulsory kill switches in the event that programs execute in an unintended manner, pre-trade risk controls to prevent “wash” trading, and increased penalties for trading that results in harm to the markets.<sup>3</sup>

While we do not have definitive views on these recommendations at this time, we support their further examination. We urge the SEC, however, to be vigilant in ensuring that mechanisms to address risks to the markets from technology be established promptly, and that these mechanisms are robust in nature. We are concerned that if long-term investors do not participate in developing the parameters surrounding, and the implementation of, these mechanisms, the markets, and investors in those markets, may not be adequately protected from further and regular market infrastructure disruptions.

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If you have any questions on our comment letter, please feel free to contact me directly at (202) 326-5815 or at [kmcmillan@ici.org](mailto:kmcmillan@ici.org), or Ari Burstein at (202) 371-5408 or at [aburstein@ici.org](mailto:aburstein@ici.org).

Sincerely,

/s/ Karrie McMillan

Karrie McMillan  
General Counsel

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<sup>2</sup> The industry working group letter can be found on the SEC’s website at <http://www.sec.gov/comments/4-652/4652-17.pdf>.

<sup>3</sup> See Speech by CFTC Commissioner Chilton, at the 2012 Allegro Customer Summit, October 16, 2012, available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-72>.

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cc: The Honorable Mary L. Schapiro  
The Honorable Elisse B. Walter  
The Honorable Luis A. Aguilar  
The Honorable Troy A. Paredes  
The Honorable Daniel M. Gallagher

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