

April 20, 2010

Via Electronic Filing

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

Re: Concept Release on Equity Market Structure, Rel. No. 34-61358; File No. S7-02-10

Dear Ms. Murphy:

The Investment Adviser Association (“IAA”)¹ appreciates the opportunity to comment on the Commission’s concept release on equity market structure.² The Commission is conducting a broad review of the current equity market structure and is evaluating a variety of market structure issues, including high frequency trading, order routing, market data linkages and undisplayed liquidity. IAA members are significant investors in the equity markets on behalf of their clients. Although investment managers are generally considered institutional investors, they manage assets for a diverse group of clients, including pension plans, investment companies, endowments, foundations, corporations, small businesses, family trusts, and individuals. Moreover, IAA members invest on behalf of both retail and institutional investors who may have short-term or long-term horizons.³ The Commission should ensure that all investors are provided equal and fair access to all trading venues and that no particular type of investor is advantaged or disadvantaged.

A fair, transparent and efficient marketplace is critical to investment advisers. We, therefore, applaud the Commission’s approach to determining whether regulatory initiatives are necessary to improve the current equity market structure through a concept release. In general, we believe the US equity markets are functioning well for investors, providing efficient execution of transactions, price transparency, and facilitating best execution of

¹ The IAA is a not-for-profit association that represents the interests of investment adviser firms that are registered with the SEC. For more information, please visit our web site: www.investmentadviser.org.

² Concept Release on Equity Market Structure, Release No. 34-61358 (Jan. 14, 2010).

³ We generally believe that it is difficult to delineate those investors who should be deemed “long-term” investors and do not believe that this type of classification is truly useful or necessary for market structure purposes.

investor orders. The US equity markets continue to lead the equity markets around the world in providing these benefits to investors. As the Commission notes in the concept release, a primary driver and enabler of the transformation of equity trading has been the continual evolution of technologies for generating, routing and executing orders, which have dramatically improved the speed, capacity, and sophistication of the trading functions.

We welcome the Commission's review of the effect of these new technologies on market structure generally and whether they have been beneficial for all types of investors. We agree that these new developments raise complex issues, which require further study. As a general matter, we urge the Commission to consider carefully the effect of any new significant regulatory proposal on the developing technologies and alternative trading systems to avoid any unintended consequence of hampering innovation and benefits to investors. We believe it is critical for investors that these innovations continue to be fostered. We comment on just a few of the issues that are raised in the concept release and will provide our views as appropriate if new specific regulatory initiatives are proposed.

Greater Transparency Needed for All Trading Venues through End of Trading Day Volume Disclosure

One proposal that we believe would be beneficial to the market and to investors is greater transparency of the execution capabilities of, and liquidity provided by, all trading venues. Such disclosure requirements should be carefully tailored to avoid harmful effects to investors seeking to execute large orders.

In trading equity securities (particularly large blocks of stock) on behalf of their clients, investment advisers, as fiduciaries, seek to ensure that investment strategies employed on behalf of their clients are implemented fully while minimizing market impact costs and preventing others from taking unfair advantage of their strategies. Investment managers are concerned that publicly revealing their significant trading interest may lead to professional traders attempting to take advantage of their investment strategy or others to front run their trades. Investment managers have used a variety of methods to avoid unnecessarily revealing their entire trading interest, including breaking up orders to smaller sizes and using trading facilities that permit transactions of orders anonymously.

In the concept release, the Commission asks to what extent one type of trading venues that permit anonymous execution of orders – dark pools – meets the objective of improving execution quality for the large orders of institutional investors. In this regard, dark pools have been critically important in assisting investment managers to minimize market impact costs. These dark pools have permitted large orders to be executed without publicly disseminating the investment manager's trading interests and strategy. We agree with many of the comments to the Commission's proposal to regulate non-public trading interest⁴ that trading venues providing undisplayed liquidity are important trading centers for asset managers that seek to minimize market impact (both implicit and explicit) costs for their client trades.

⁴ Regulation of Non-Public Interest, Release No. 34-60997 (Nov. 13, 2009).

To evaluate the liquidity of competing trading venues and to determine the most appropriate alternative trading venue for routing orders, investment managers would find disclosure of trading volume of a stock by trading venue to be beneficial. We believe, however, that this benefit must be carefully weighed against our concerns regarding front-running and market impact costs.

To obtain the benefits of greater transparency regarding liquidity while minimizing the harm to investors seeking to execute large orders, the IAA recommends that the Commission require the reporting at the end of the day of the volume of trades for individual stocks in each trading venue. Increasing the transparency of trade volume for all trading venues would allow investment managers to assess better which trading venue may have the liquidity and capacity to execute transactions with respect to a particular stock or types of stocks while protecting proprietary trading information.

In recommending greater transparency, we urge the Commission not to require contemporaneous (intraday) disclosure by each venue of the trades executed for a specific stock. Contemporaneous disclosure may jeopardize the ability of asset managers to execute the entire order and permit professional traders to take advantage of asset manager strategies because a large trade order may take some time to complete and information regarding the asset manager's trading interest would start to leak. Therefore, contemporaneous disclosure would diminish greatly the value of these trading venues.

Moreover, any disclosure requirement should be extended not only to dark pools but to broker-dealers that internally execute trades. As the Commission notes, the internalized execution of broker-dealers are not included in the consolidated quotation data and therefore should be classified as undisplayed liquidity.⁵ Given the significant volume of shares that are executed through broker-dealer internalization, increasing the transparency of the volume on a broker-dealer by broker-dealer basis would permit investment managers to evaluate all trading venues with equal information.

Rules 605 and 606 Reports Are Not Useful for Investors

In the concept release, the Commission asks whether long-term investors and their brokers have the tools they need to protect their own interest in a dispersed and complex market structure. Specifically, the Commission asks whether reports required under Rules 605 and 606 of Regulation NMS continue to provide useful information for investors and their brokers in assessing the quality of order execution and routing practices. Rule 605 requires market centers to make available standardized, monthly reports of statistical information concerning their order execution. Rule 606 requires disclosure of order routing information on a broker-by-broker basis.

⁵ According to the Commission, for example, in the third quarter 2009, broker-dealer internalization accounted for approximately 17.5% of share volume in NMS stocks while dark pools executed approximately 7.9% of share volume in NMS stocks.

IAA members generally do not find the Rules 605 and 606 reports useful in determining which market centers to route orders. We urge the Commission to revise the reports to make them more useful to investors. As the Commission states in the concept release, these rules were drafted primarily with the interests of individual investors in mind and focused on the execution of smaller orders. The exclusion of large orders in these reports limits the value of these reports to institutional investors. Moreover, the format and the presentation of information in those reports (especially 605 reports) make the information difficult to analyze.⁶

Terms of Co-Location Should be Fair

The Commission also requests comment on the tools used by proprietary firms to implement their short-term trading strategies. One of the tools is co-location, which permits market participants to place their servers in close physical proximity to a trading center's matching engine to minimize network and other types of latencies. The IAA believes co-location services to be an acceptable practice but urges the Commission to ensure that the terms of the co-location services be fair and transparent, based on fees that are equitably allocated and reasonable. Co-location services should not unfairly discriminate based on non-objective factors, such as type of investor or firm. The competitive landscape should be level, with market participants able to compete to provide best execution and investors able to seek out those who provide best execution.

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The IAA strongly supports the Commission's efforts to evaluate the equity market structure to ensure that a national market system continues to be in the public interest and appropriate for the protection of investors. We believe that, although the US equity markets have changed dramatically over the years, they continue to serve investors well. We encourage the Commission to consider carefully any new regulatory initiatives on alternative trading systems to prevent unintended consequences that may have negative effects on investors. We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned or Karen L. Barr, General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

/s/ Jennifer S. Choi

Jennifer S. Choi
Assistant General Counsel

⁶ See Letter to Gene Gohlke, Associate Director, OCIE, from Philippa Hughes, Counsel, IAA (then the Investment Counsel Association of America) (Jan. 28, 2003) (requesting guidance on the use of these reports because the reports are "lengthy, complicated, and very difficult to read, understand, and analyze").

cc: The Honorable Mary L. Shapiro, Chairman
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

Robert W. Cook, Director
Division of Trading and Markets

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