March 1, 2010

Via Electronic Mail

Ms. Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **Purchases of Certain Equity Securities by the Issuer and Others; File No. S7-04-10**

Dear Ms. Murphy:

Investment Technology Group, Inc. ("ITG") appreciates the opportunity to comment on the proposal by the Securities and Exchange Commission ("SEC" or "Commission") to amend Rule 10b-18 under the Securities Exchange Act of 1934 ("Exchange Act").[1] Rule 10b-18 provides issuers with a "safe harbor" from liability for manipulation when they repurchase their common stock in the market in accordance with the rule's conditions on manner, timing, price, and volume conditions. ITG is an independent agency brokerage and financial technology firm that partners with asset managers globally to improve performance throughout the investment process. ITG operates an alternative trading system ("ATS") called POSIT® that conducts matches of non-displayed, unpriced orders from institutional investors and broker-dealers.

I.   <u>Commission's Proposed Amendments to Rule 10b-18</u>

The proposed amendments would update the rule's provisions in light of market developments since the rule was adopted in 1982. ITG supports efforts to modernize the provisions of the rule given the enormous changes in trade execution practices and venues since the rule was adopted. We believe, however, that the proposal should provide more flexible relief from the pricing conditions for volume-weighted average price ("VWAP") trades and should include an exemption for orders sent to ATSs that are passively priced to execute between a stock's national best bid and offer ("NBBO"). As discussed below, our suggested changes would enhance the ability of issuers to avail themselves of order handling methods and execution venues without posing any manipulative or market impact concerns.

As noted above, Rule 10b-18 provides a "safe harbor" from the anti-manipulation provisions of the Exchange Act for issuers repurchasing their securities. Although the rule is intended to act only as a safe harbor, and does not preclude issuers from effecting repurchases

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[1] Exchange Act Release No. 61414 (January 25, 2010) ("proposing release").

outside of the rule's provisions, our experience has been that issuers are reluctant to buy back their securities outside of the conditions of the safe harbor. One of the concerns regarding the safe harbor for ATSs such as POSIT that execute orders on a passive basis, at prices within the NBBO, is the rule's pricing condition. This criterion limits an issuer to bidding or buying its security at a purchase price that is no higher than the highest independent bid or last independent transaction price, whichever is higher, that is quoted or reported on the consolidated tape at the time the purchase is effected. This condition acts as an impediment to a passively priced issuer repurchase execution at a price within the NBBO because that price will be above the highest independent bid and could also be above the last independent transaction price.

II.   Proposed VWAP Exception to the Pricing Condition

The SEC proposes to address the issues concerning the ability of passively priced executions to comply with the pricing conditions by amending Rule 10b-18 to except from the price condition any purchases effected on a VWAP basis.[2] We strongly agree that a VWAP purchase does not implicate any of the manipulative concerns that the rule's pricing condition is designed to prevent. However, the Commission's proposed exception would only apply to VWAP transactions in actively traded securities that are entered into or matched before the regular trading session opens and the VWAP execution price must be determined based on a full day's trading volume. Moreover, the VWAP can not include (1) trades effected as the stock's opening purchase or during the last 10 minutes of trading before the scheduled close of the regular trading day, and (2) trades effected at a price that exceeds the highest independent bid or last independent transaction price, whichever is higher, at the time such trade is effected. Finally, to qualify for the exception, the issuer's VWAP purchase also must not exceed 10% of the ADTV in the security and must not be effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.

We believe that the conditions placed on the proposed VWAP exception are unnecessarily constraining and should be modified to provide more flexibility in arranging a VWAP purchase. A VWAP transaction should not have to be based on an entire day's trading activity in order to be presumed as non-manipulative in nature. We suggest that a VWAP transaction consisting of trades occurring during at least a three hour period should be exempt from the pricing condition. Furthermore, the VWAP should be permitted to include trades effected: (1) at the opening; (2) during last 10 minutes of trading; and (3) at prices that would otherwise violate the pricing condition. A VWAP of at least three hours is long enough, particularly for actively-traded securities, to incorporate a sufficient number of trades to provide an average price that is unlikely to be used to manipulate a security's price. Moreover, as such a trade would have a weighted price modifier attached to the tape report, it would not provide any misleading indication to the marketplace as to the price direction of the stock. Even if the Commission decides to maintain a full-day VWAP as a condition, the other conditions to the

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[2] The Commission previously raised the possibility of whether passive pricing mechanisms such as a VWAP trade should be excluded from the rule's pricing condition. See, Exchange Act Release No. 46980 (December 10, 2002) ("2002 Release").

exception would prevent the VWAP execution from reflecting an accurate VWAP. Specifically, the application of the pricing and time conditions to the trades constituting the VWAP execution would not only be extremely difficult to administer, such action would also skew the resulting VWAP price in an artificial manner.

III. Proposed Exception for Passive Pricing Systems

The proposing release also states that the Commission is considering whether to except other passive pricing mechanisms from the rule's price condition. The release notes that some issuers may want to effect repurchases through ATSs that use passive or independently-derived pricing mechanisms, such as mid-point of the NBBO or "mid-peg" orders. As these mid-peg orders will be above the highest independent bid and might occur at a price above the last independent sale price, they could fall outside of the rule's price condition. For example, suppose the NBBO of a stock is 20.00 to 20.04. A midpoint execution at 20.02 would violate the pricing condition if the last independent transaction price is 20.01 or lower because the match would occur above this transaction price. At the time the midpoint execution is effected, it is entirely fortuitous whether a trade has just occurred close to the bid side or the sell side of the NBBO. This reality makes it extremely difficult to use passively priced midpoint execution systems for Rule 10b-18 purchases, for fear of violating the pricing condition. Accordingly, many issuers are hesitant to avail themselves of passively priced matching systems due to the possibility of violating the pricing condition of Rule 10b-18.

The SEC seeks comment on whether to expand the possible exceptions to the pricing condition to include issuer repurchases effected through electronic trading systems that match and execute trades at various times and at independently derived prices, such as the midpoint of the NBBO. The proposing release notes that it may be appropriate to expand the safe harbor to permit an issuer to submit a buy order pegged to the midpoint of the NBBO at the time of execution if the order is matched and executed against a sell order pegged to the midpoint of the NBBO. The proposing release cites in footnote 66 the relief provided by the SEC from former Rule 10a-1, the short sale tick test, for POSIT's midpoint crossing system in 2003. The proposing release then sets forth seven conditions to the possible midpoint exemption that is under consideration: (1) matches must occur at an externally derived price within the existing market and above the current national best bid; (2) sellers and purchases are not assured of receiving a matching order; (3) sellers and purchasers do not know when a match will occur; (4) persons relying on the exception are not represented in the primary market offer or otherwise influence the primary market bid or offer at the time of the transaction; (5) transactions in the electronic trading system are not made for the purpose of creating actual, or apparent, active trading in, or depressing or otherwise manipulating the price of, any security; (6) the covered security qualifies as an "actively traded security" (as defined in Rule 101(c)(1) of Regulation M; and (7) during the period of time in which the electronic trading system may match buying and selling interest, there is no solicitation of customer orders, or any communication with customers that the match has not yet occurred.

ITG strongly believes that an exception from the pricing condition should be provided for Rule 10b-18 purchase orders that are submitted to an ATS pegged for execution at a price within

the NBBO at the time of execution, if matched against a sell order submitted for execution within the NBBO. As indicated above, the SEC has indicated a willingness in the past to consider granting relief from the pricing condition for "passive" (independently-derived) pricing systems where the match price is derived from the midpoint of the NBBO.[3] We believe that passively priced trades present little if any potential for manipulative abuse as these transaction prices are established solely in reference to the NBBO in existence at the time of execution. The market price for securities traded in these systems are generally unaffected by trades occurring in the system. Specifically, the passively priced trades are effected within the NBBO and the purchases in the system do not absorb sell liquidity residing in the publicly display markets (*i.e.*, they do not wipe out displayed offers in the open market). Furthermore, issuers entering repurchase orders in such systems are not guaranteed a match and therefore can not be sure that their order will be executed at all. Moreover, issuers seeking to repurchase shares through a "dark" ATS such as POSIT cannot create the appearance of large demand for their stock, as their order is not known by anyone other than the operator of POSIT. As a result, trading through POSIT by issuers is not the type of activity that an issuer would engage in if it had a manipulative intent or sought to induce others to purchase shares based on actual or apparent market activity

We have some suggestions to improve the passive pricing exception that is being considered by the Commission. First, the exception should apply to any issuer buy order that is conditioned to be executed within the NBBO, not merely at the midpoint. Crossing systems such as POSIT have evolved since the 2002 Release to incorporate matches at price points within the NBBO other than the midpoint. A match other than at the midpoint of the NBBO should not raise concerns as long as the issuer's buy order was pegged to occur within the NBBO and the match occurs within the NBBO (i.e., below the best offer). For example, if the NBBO is 10.00 to 10.04, an issuer, through its broker-dealer, may submit a Rule 10b-18 purchase order to an ATS that is pegged to the NBBO midpoint. At the same time, an institutional investor may submit an order to the same ATS to sell at the inside bid or better. If the ATS is limited to crossing orders at the NBBO midpoint, the match would occur at 10.02, with only the institutional seller receiving price improvement of 0.02. However, if the ATS was equipped with the functionality to cross orders at passively or independently determined prices within the NBBO other than at the midpoint, then the match could occur at 10.01, thereby providing the buyer and seller each with 0.01 price improvement. We also recommend that the SEC clarify that the proposed relief extends to continuous matching systems, not just periodic matching systems. POSIT, like most matching systems, has migrated away from periodic matches several times a day to continuous matches in response to investor demand.

As mentioned above, the proposing release provides that in order to comply with the passive pricing mechanism exception, the sellers and purchasers must not know when a match will occur. This condition can be fulfilled in a continuous matching system that is "dark" in that interest in the system is not displayed to any other participants. Thus, an issuer entering a passively-priced order will have no assurance that contra-side sell interest exists to execute against at the time of entry of its buy order. In other words, the condition should be satisfied if an

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[3] See, 2002 Proposing Release.

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issuer entering a buy order into a dark crossing system has no knowledge or assurance that its order will be matched against a contra-side sell order. Finally, we recommend deletion of the last proposed condition that during the period of time in which a match can be effected, there is no communication with customers that a match has not yet occurred. This condition is a vestige of the former periodic match structure of POSIT and does not reflect the continuous match functionalities offered by POSIT and other passive matching systems. It makes little sense to prohibit a matching system from communicating to a customer that its passively priced order has not been matched.

The proposing release notes that a passively priced trade is not reported using any special trade modifier to indicate to the market that the price is based on a special pricing formula. The Commission is concerned that a sizeable midpoint purchase or series of purchases by an issuer may result in the issuer leading the market through its repurchases. We believe that this is highly unlikely for several reasons. First, trades occurring within the NBBO do not provide strong directional signals to the market. Second, trades in passively priced systems such as POSIT do not change the NBBO as they do not absorb pricing interest in the markets establishing the NBBO.

We appreciate the opportunity to comment on the Commission's proposal to amend Rule 10b-18. Although we believe that the proposal is moving in the right direction, the Commission should take more affirmative steps to accommodate issuer repurchases effected through passively priced crossing systems in accordance with the recommendations referenced in this letter. Should you require further clarification or have any questions regarding the above, please do not hesitate to contact me.

Sincerely,

P. Mats Goebels
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