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February 25, 2010

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

**Re: Regulation of Non-Public Trading Interest
Release No. 34-60997;
File No. S7-27-09**

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities (the "Committee") of the Section of Business Law of the American Bar Association (the "ABA") in response to the request for comments by the Securities and Exchange Commission (the "Commission") on the Commission's proposed amendments to Regulation NMS and related rules (the "Proposed Amendments") under the Securities Exchange Act of 1934 (the "Exchange Act").¹ This letter was prepared by members of the Committee's Subcommittee on Trading and Markets, with input from other members of the Committee.

The comments expressed in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, these comments do not represent the official position of the ABA Section of the Business Law, nor do they necessarily reflect the views of all members of the Committee.

The Committee would like to thank the Commission for this opportunity to comment on the Proposed Amendments. We write to make several points. First, although the Proposing Release contains some data about the absolute volume of trading in "dark pool" alternative trading systems, it does not contain any data about who is using the dark pools or why. As the Commission recognizes, investors voluntarily choose to use dark pools, and no investor is forced to have his or her orders routed to a dark pool for display or execution. We believe that a more comprehensive exploration of which market participants currently choose this alternative, and the factors that induce them to do so, would significantly benefit the Commission's decision-making. For example, if dark pools are used primarily by registered market-makers to submit indications of interest that are (implicitly or explicitly) better priced than the quotes they make publicly available,

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Exchange Act Release No. 60997 (Nov. 13, 2009) (referred to herein as the "Proposing Release").

certain policy implications would likely flow from that fact. However, if dark pools are used in large part by institutional investors, including long-term investors such as mutual funds and pension plans which seek to establish or liquidate long-term positions, the Commission might draw different policy implications. The Commission's recent concept release on market structure draws a similar distinction between high frequency traders and long-term investors, and expresses the Commission's longstanding view that to the extent the interests of short-term traders and long-term shareholders diverge, the Commission's statutory mandate to encourage capital formation requires it to favor the interests of long-term shareholders.² Indeed, as discussed further below, the Proposing Release itself exempts some "size discovery" orders from the Proposed Amendments in order to allow certain institutional investors with a long-term investing horizon to retain some of the benefits of the current dark pool structure. However, the Proposing Release does not provide any information to indicate the extent to which (aside from the few dark pools cited in the Proposing Release focusing exclusively on block-size orders) these long-term institutional investors are using dark pools.³ We believe the Commission and commenters would benefit from information about who is using dark pools and why. Because the Commission, pursuant to Regulation ATS Rule 301(b)(9)(i) and the reports filed by alternative trading systems on Form ATS-R, has available to it all subscribers granted access to each registered alternative trading system, we believe it should be able to obtain this information.

Second, a central concept in the Proposing Release is an "actionable indication of interest" or "actionable ICI." The Proposed Amendments would include "actionable IOIs" (other than the size-discovery orders discussed above) in the definition of "quotation" for the purposes of Regulation NMS Rule 600 and Regulation ATS Rule 301(b). However, the Commission has not provided a definition of "actionable" either in the Proposing Release or the Proposed Amendments. Given the significant regulatory consequences of the distinction between actionable and non-actionable indications of interest, we believe the interests of fair notice and opportunity for public comment would be best served if the term were clearly and explicitly defined in the Proposed Amendments. Further, the Proposing Release seems to suggest that the determination of whether an IOI is actionable may be a facts and circumstances test depending on the context in

² See Concept Release on Equity Market Structure, Exch. Act Rel. No. 61358 (Jan. 14, 2010) ("Market Structure Concept Release") at Section IV.A.1. The Commission states that long-term investors "are the market participants who provide capital investment and are willing to accept the risk of ownership in listed companies for an extended period of time." *Id.* However, capital is provided directly to issuers by venture capitalists, underwriters and others that purchase securities directly from issuers, not from those who trade the issuers' securities in the secondary markets. The liquidity that secondary markets provide makes it easier for issuers to raise additional capital through follow-on offerings, but it is not clear that the liquidity provided by short-term traders is any less valuable in this regard than liquidity arising from trades by long-term holders.

³ As the Proposing Release notes, although the average size of orders executed in dark pools is relatively small, the same is true for the average size of orders executed on exchanges. See Proposing Release, text accompanying nn.11-13. For this reason, as the Proposing Release acknowledges, the small average size of these executed orders in dark pools does not indicate whether those orders are part of larger "parent" orders being placed by institutional investors with a long-term time horizon.

which the order is received.⁴ As we understand dark pools, they are highly automated in order to handle hundreds or even thousands of orders per second, and an individual would be unable to analyze the context of these orders so as to categorize them as actionable. For this reason, we suggest that there should be a bright-line test for "actionability" that a dark pool operator can program into the system's computer logic in order to comply with the Proposed Amendments.

Moreover, as the Proposing Release recognizes, dark pool indications of interest typically do not explicitly specify price or size, or in some cases either price or size. The Regulation NMS quote stream requires both price and size. If these indications of interest are to be integrated into the quote stream, we respectfully request that the Commission give express guidance about how this is to be accomplished - in other words, guidance about exactly how the size and price are to be inferred. Once again, successfully integrating indications of interest into the quote stream would require bright-line rules capable of automation. To require a person to make pre-order routing, facts-and-circumstances judgments on hundreds or thousands of orders per second will not be practicable. If the Commission does have a bright-line rule in mind (for example one based on the national best bid or offer and the minimum quotation increment for a given security), we urge it to make that rule explicit and provide an opportunity for comment on that rule.

On a more philosophical level, there is a tension in the Proposing Release between two of Congress' national market system goals set forth in Exchange Act Section 11A: transparency and economically efficient execution of securities transactions. The Proposing Release explains the need for the Proposed Amendments in terms of improving transparency, but then goes on to exclude from the release "size-discovery" orders that would be the most material to other market participants, on the ground that without this exclusion, the executions available to institutional investors would be harmed. We urge the Commission to be more explicit in recognizing the trade-off between transparency and economically efficient execution of transactions and in explaining how it balances these goals. In other words, it is not clear from the Proposing Release why the Commission has concluded that the current regulation of dark pools creates a "two-tiered" market, but the proposed "size-discovery" exception would not also create a "two-tiered" market, only with different tiers. This is not to say that the "size-discovery" portion of the proposal is inappropriate, rather that the Commission should explain how it is balancing two statutory mandates which in this instance appear to conflict.

Some members of the drafting committee have suggested that there may be similar reasons for including "child" orders of "size-discovery" orders in the "size-discovery" exception. They note that institutional clients often split their orders into smaller "child" orders to avoid information leakage and to improve the quality of their executions, which are the same considerations that led the Commission to propose excluding "size-discovery" orders from the display requirement in the first place. Whether this suggestion is consistent with the Commission's proposal depends on how it balances the objectives of transparency and efficient execution of transactions. This is yet another reason why we urge the Commission to explain how it is balancing these statutory objectives. We also note that securities orders ordinarily are

⁴ See Proposing Release, text accompanying n.21: "Although these IOI's may not explicitly specify the price and size of available trading interest at the dark pool, the practical context in which they are transmitted renders them 'actionable' [.]"

expressed in terms of numbers of shares, not in dollar terms (which is difficult to predict precisely prior to execution), and we question whether the having a dollar-size test for "size-discovery" orders is helpful or workable.

Last, the Proposing Release does not ask any questions about whether the Proposed Amendments simply will serve to drive transactions to off-shore markets. If market participants find dark pool orders an economically efficient means to execute their long-term trading strategies but the Commission takes away a primary perceived benefit of U.S.-based dark pools, is there anything that would prevent those market participants from executing those orders in a Toronto, London or Bermuda-based trading system?⁵ We suggest that the Commission provide a cost-benefit analysis comparing the anticipated benefits of the Proposed Amendments with the effects (quantitative and qualitative) of causing some transactions to migrate to non-U.S. markets, with different post-trade transaction reporting requirements and clearance and settlement systems. If the Commission concludes that a substantial number of transactions would migrate off-shore, we believe that migration could result in a net harm to the quality of the U.S. securities markets and to the protection of U.S. investors. The Commission might conclude that the risk of transactions moving off-shore is low and the benefits of increased transparency outweigh that risk, but we urge the Commission explicitly to address this trade-off. The lack of discussion of off-shore alternatives in the dark pools Proposing Release contrasts to the Market Structure Concept Release, which asks a variety of questions about the effects of globalization and the potential for trading activity to move overseas.⁶

Once again, the Committee appreciates the opportunity to submit these comments. Members of the Committee are available to meet and discuss these matters with the Commission and its staff and to respond to any questions.

Very truly yours,

/s/ Jeffrey W. Rubin

Jeffrey W. Rubin, Chair of the Committee on
Federal Regulation of Securities

To the extent that the Commission believes there are legal impediments that would prevent some or all market participants from moving their trading activity overseas to take advantage of foreign market structures no longer available in the United States, it would be helpful for the Commission to identify those impediments and to give those participants notice that they are at risk of an enforcement response.

See Market Structure Concept Release at Section IV.A.

Securities and Exchange Commission

February 25, 2010

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