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February 22, 2010

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

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

Dear Ms. Murphy:

BNY ConvergEx Group, LLC ("ConvergEx") appreciates the opportunity to comment on the proposal by the Securities and Exchange Commission (the "Commission") to amend certain of the rules applicable to Alternative Trading Systems ("ATSs") and others, particularly with respect to so-called "dark pool" ATSs, as described in Release No. 34-60997 (Nov. 13, 2009), published at 74 FR 61208 (Nov. 23, 2009) ("Proposing Release").

ConvergEx Group is a premier provider of investment technologies and execution solutions to institutional clients worldwide. Our offering includes a broad range of sophisticated technologies and innovative strategies designed to provide clients with the ability to gain access to liquidity while bringing value and cost efficiency to transactions. We offer some of the most advanced tools in the industry, specifically designed to help institutional investors have more choice and control over their execution strategies while addressing cost, timing, performance and market structure requirements. Key among these include our three proprietary ATSs -- ConvergEx Cross[SM], VortEx[SM], and Millennium ATS. ConvergEx Cross is a block trading venue for institutional customers, VortEx is a continuous midpoint crossing ATS for institutional customers, and Millennium ATS, which until recently was known as NYFIX Millennium, is a continuous crossing ATS for institutional and broker-dealer subscribers. All three ATSs leverage our sophisticated, proprietary technologies and are designed to provide reliable, anonymous sourcing of liquidity, enabling clients to remain competitive and flexible. Each of the ConvergEx ATSs executes orders on an agency cross basis, and ConvergEx does not act as a market maker in any NMS stock or trade with any of its institutional customers in any of its ATSs on a proprietary basis. Both VortEx and Millennium utilize some forms of indications of interest ("IOIs"). Consequently, ConvergEx believes that it is well-qualified to comment on the potential impacts of the rules proposed in the Proposing Release.

In the recently published Concept Release on Equity Market Structure,[1] the Commission reiterated the framework established by Congress under which regulations relating to the establishment and maintenance of a national market system should be considered and promulgated. In order for such regulations to meet the requisite goals of ensuring the protection of investors and the maintenance of fair and orderly markets, the Securities Exchange Act of 1934, as amended ("Exchange Act") lists the following five objectives of our national market system:

> (1) economically efficient execution of securities transactions;
> (2) fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets;
> (3) the availability to brokers, dealers, and investors of information with respect to quotations and transactions in securities;
> (4) the practicability of brokers executing investors' orders in the best market; and
> (5) an opportunity, consistent with efficiency and best execution, for investors' orders to be executed without the participation of a dealer.[2]

Recognizing that these five objectives may conflict in some instances, the Commission concluded that its job is to find the appropriate balance among these competing objectives.[3]

Our comments on the Proposing Release, set forth below, are intended to help the Commission find that balance (or see that it may already exist) in order to effectuate an effective national market system that takes account of the competing interests of those market participants. In Section I below, we set forth some general themes in support of dark liquidity, which are intended to address the mistaken belief held by some that dark liquidity is inherently bad. Generally, we intend to show that dark liquidity serves an important and useful role in our national market system, and that the Commission historically has supported the idea that dark liquidity can be beneficial to our markets. We urge the Commission to carefully balance the competing interests of all market participants, including those that benefit from dark liquidity, before it adopts new rules relating to dark liquidity, particularly when it is simultaneously considering broader changes to our national market structure. In this regard, we demonstrate that the current markets are not skewed in favor of dark markets over light markets such that drastic regulatory changes are necessary.

After our general discussion on the benefits afforded by dark liquidity, we will address the specific rules proposed in the Proposing Release in Section II below. We appreciate the Commission's stated objectives in this area, and our comments will be framed with those in mind. As you will see, we attempt to apply the Exchange Act's five objectives of a national market system to each of the proposals set forth in the Proposing Release, and where appropriate,

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[1] See SEC Release No. 34-61358 (Jan. 14, 2010), 75 FR 3594 (Jan. 21, 2010) (hereafter, the "Concept Release"). ConvergEx will be submitting a separate comment letter regarding issues raised in that Concept Release.

[2] See Section 11A of the Exchange Act, 15 U.S.C. §78k-1. See also Concept Release, 75 FR at 3596.

[3] Concept Release, 75 FR at 3597.

provide an alternative recommendation to the Commission that provides what we believe is an appropriate balance of such interests. With this as background, we respectfully submit our views on the Proposing Release.

I. In Support of Dark Liquidity

A. Dark Liquidity is Important to an Efficient Marketplace

Applying the stated objectives to our current market structure, it is clear that ATSs, including dark pool ATSs, are important to the efficient functioning of our securities markets. The Commission has historically supported the development of such broker-dealer proprietary trading systems, and has recognized that they are different than exchanges and serve a different purpose. For example, in connection with its 1989 proposal of Rule 15c2-10,[4] which would have formalized the approval and oversight of proprietary trading systems (which until then had been regulated on a more *ad hoc* basis), the Commission noted its belief that

> [t]he proprietary systems that have developed to date are distinguishable in function from exchange markets. These proprietary systems offer to participants the capacity to execute automatically transactions based on derivative pricing and also offer the opportunity to advertise purchasing and selling interest. These systems have not, however, evolved into interdealer quotation or transaction mechanisms in which participants enter two-sided quotations on a regular or continuous basis, thus ensuring a liquid marketplace. ... In light of the differences between existing proprietary systems and exchange marketplaces and the potential burdens on competition which might arise, the Commission believes at this time that the existing proprietary systems are not required to register as exchanges. The Commission believes that subjecting proprietary trading systems to exchange registration pursuant to Section 6 would substantially deter development of innovative trading systems. The Commission believes that it is desirable for certain trading and quotation systems to be operated as proprietary businesses, rather than as self-regulatory organizations ("SROs") so long as each system is subject to an appropriate level of Commission oversight.[5]

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[4] See SEC Release No. 34-26708 (April 11,1989), 54 FR 15429 (April 18, 1989). Among other things, that Rule would have required sponsors of broker-dealer trading systems to submit for Commission approval a business plan describing the method of operation of the system, including the procedures governing the entry of indications of interest, quotations and orders. Rule 15c2-10 was originally proposed in 1969, but was withdrawn following the 1975 amendments to the Securities Exchange Act of 1934, pursuant to which Section 11A, listing the five objectives of a national market system, was added to the Exchange Act. See SEC Release No. 34-11673 (Sept. 23, 1975).

[5] SEC Release No. 34-26708, 54 FR at 15433. See also Remarks of Commissioner J. Carter Beese, Jr., U.S. Securities and Exchange Commission, "Patterns of Integration in and among International Financial Markets,"

In fact, the Commission explicitly noted that several of the trading systems that would have been subject to the proposed Rule were designed to serve large institutional investors and "because these large institutions have far greater capacity to assess and avoid trading risk than do small retail investors, the Commission is satisfied that the purpose of the Act in applying the incremental protections afforded by exchange registration [as opposed to broker-dealer registration] would not be served by their application to these systems."[6] Furthermore, as proposed, the Rule would not have applied to systems that limited their activities to their own customers: "The Commission believes that a system in which all transactions are executed by the broker or dealer for itself or its customers does no more than automate the internal execution functions traditionally engaged in by an integrated broker-dealer."[7]

Five years later, in connection with its proposal and adoption of Exchange Act Rule 17a-23,[8] which required broker-dealer trading systems to, among other things, provide certain information about themselves to the Commission, the Commission reiterated its view that broker-dealer trading systems should be regulated differently from exchanges. In its proposing release for Rule 17a-23, the Commission rejected the view of some commenters who had argued in connection with Rule 15c2-10 and the Commission's Market 2000 Study that broker-dealer trading systems ("BDTSs") should be regulated similarly to exchanges, and not regulated as broker-dealers:

> They have argued that certain BDTSs compete for order flow with exchanges and should be subject to exchange registration and regulation. ...The Commission disagrees. There are many different competitors for order flow, e.g., derivative products, upstairs dealers, third market makers, and BDTSs. These should not all be regulated identically simply because they compete for market share. The level of regulation should be tailored to functions being performed by an entity and the corollary need for regulation. The functions performed by BDTSs are most closely aligned with the

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Promethee/Euroclear Symposium, Brussels, Belgium, October 1, 1993 ("I have never believed that the best way to level the competitive playing field is to simply heap additional burdens on the less-regulated .... The limited requirements of proposed Rule 15c2-10 are intended to provide the SEC with an effective means of monitoring the activities of proprietary trading systems to assure that they are complying with U.S. federal securities laws; and that investors who use these systems are adequately protected. At the same time, the SEC recognized that subjecting proprietary trading systems to registration requirements along the lines of exchange regulation would substantially deter development of innovative trading systems. Proposed Rule 15c2-10 is intended to strike the middle ground by providing the SEC with a balanced means of overseeing the activities of proprietary systems.")

[6] Id. , SEC Release No. 34-26708.

[7] Id. The Commission also proposed to exempt proprietary trading systems that linked introducing brokers to an executing/clearing firm from the Rule. Id. at n. 47.

[8] Proposed Rule 15c2-10 was withdrawn in 1994 and essentially replaced with Exchange Act Rule 17a-23. See SEC Release No. 34-33605 (Feb. 9, 1994) (proposing Rule 17a-23), and SEC Release No. 34-33621 (Feb. 14, 1994) (withdrawing proposed Rule 15c2-10). See also SEC Release No. 34-35124 (Dec. 20, 1994) (adopting Rule 17a-23).

> functions performed by broker-dealers; consequently, broker-dealer regulation of BDTS sponsors is appropriate.[9]

In adopting Rule 17a-23, the Commission, applying the five objectives of Section 11A, further recognized that electronic trading through BDTSs provided significant benefits, including the reduction of transaction costs, the promotion of competition, the improvement of market transparency, increased opportunities for best execution and the expansion of opportunities for orders to be executed without the participation of a dealer.[10]

Regulation ATS,[11] which replaced Rule 17a-23 and implemented many of the provisions that had been included in proposed Rule 15c2-10, also recognized the important role that electronic trading, as well as non-displayed liquidity, play in making our markets more efficient.[12] In adopting Regulation ATS, the Commission once again recognized that BDTSs, now called ATSs, should not be regulated like exchanges – in fact, ATSs are exempted from exchange registration under Section 6 as long as they meet the definition of an ATS, are registered as broker-dealers (and comply with the rules applicable to broker-dealers), and comply with the provisions of Regulation ATS.

We recognize that Rule 301(b)(3) of Regulation ATS, which requires the inclusion in the public quotation stream of certain orders displayed in an ATS, was intended to enhance the transparency of orders displayed in ATSs under certain circumstances. The Commission balanced the desire for more transparency in general, however, with the legitimate needs of some market participants for less transparency. Evidencing the view that dark liquidity serves a useful market purpose, the Commission provided an exemption from that display requirement to ATSs with less than 5% of the trading volume in any covered security. It also explicitly exempted from this requirement those ATSs that do not display subscriber orders to more than one system subscriber, on the basis that, if it does not display its orders to subscribers, an ATS should not be required to display orders to non-subscribers. In response to institutional investor concerns, the Commission made clear that it was not requiring the display of all orders sent to ATSs in the public quote stream, but only those orders that the subscribers had already decided to display to other subscribers.[13] Furthermore, the Commission determined that, if only a portion of a subscriber's order was displayed to other subscribers, the undisplayed portion (*e.g.*, reserve size) would not be subject to the public display requirements of Rule 301(b)(3).[14]

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[9] See SEC Release No. 34-33605, at fn. 10.

[10] Id., SEC Release No. 34-33605, at text corresponding to fn. 12.

[11] 17 CFR §§ 242.300-303.

[12] See SEC Release No. 34-40760 (Dec. 8, 1998), 63 FR 70844 (Dec. 22, 1998) (the "ATS Adopting Release").

[13] Id.; See also 63 FR at 70869.

[14] Id., 63 FR at 70866.

Thus, in balancing the competing objectives for a national market system, the Commission has clearly accepted the idea that dark liquidity is a beneficial part of markets. By including exemptions from the public order display requirements for "dark" ATSs, the Commission has encouraged the continued existence of dark liquidity. Indeed, as will be discussed below, several features of the Commission's new proposals relating to dark liquidity continue to reflect an acknowledgement that dark liquidity plays an important role in the efficient functioning of the markets. Overall, however, we do not believe that the Commission has found the appropriate regulatory balance between light and dark liquidity in connection with its proposed rules in the Proposing Release. It instead appears that the Commission may be moving towards a regulatory framework under which ATSs and exchanges will be subject to similar regulation despite their structural and practical differences, in derogation of the careful balancing required of the five objectives for a national market system.

B. A Careful Analysis is Needed to Find the Appropriate Balance Between Dark Liquidity and Light Markets

As indicated in the Commission's Concept Release, our current market structure (including the regulation of dark liquidity both inside and outside of dark pool ATSs) is the result of the Commission's balancing of the competing interests of market participants and the five objectives noted above. Before the Commission makes substantive changes to the structure of our equity markets by changing the fundamental ways in which market participants interact with dark liquidity, it should first establish that its previous careful balancing of the five objectives is no longer valid.

The Proposing Release appears to be directed to finding a solution to a claimed "problem" – the proliferation of dark pool ATSs and the purportedly negative impact of dark liquidity on the securities markets. We question, however, whether such a "problem" actually exists in today's markets. Misleading and uninformed articles in the press, and the attempts by some to associate the existence of dark liquidity with unrelated questionable practices by other market participants (*e.g.*, flash orders) with the intent of painting all dark liquidity as somehow bad for the markets, should not form the basis of a Commission rulemaking. While we applaud the Commission's efforts to make the U.S. securities markets more transparent, where warranted, for all participants, we believe that any resulting changes to market structure should be based on findings that are based on fact, not myth.

As a general matter, we believe that dark pools offer benefits and market efficiencies not available elsewhere in the national market system. The existence and proliferation of dark pools has had an overall positive impact on the markets: the competition between light and dark market centers (stock exchanges, ECNs and ATSs operating like exchanges, dark ATSs and OTC market makers) has resulted in a significant decrease in quotation spreads and transaction costs on the public markets, which has benefitted all investors.[15] Dark pools provide institutional

[15] It is not surprising that the registered exchanges are attempting to "cry foul" and advocating for more regulation of ATSs since ATSs, because of the efficiencies they offer over exchanges, have taken some market share away from exchanges. (It is also ironic, since some registered exchanges are the recipients of IOIs from ATSs and themselves route orders to ATSs for execution.) This argument, however, is nothing new – in comments made regarding the Commission's 1989 proposal for registration of broker-dealer trading systems through Rule 15c2-10,

investors (including mutual funds, pension funds and broker-dealers trading on behalf of their retail and institutional customers) with lower cost executions, price improvement and flexibility in getting their trades executed while minimizing information leakage that would otherwise be detrimental to them. Dark pools also provide investors and other market participants with the opportunity for their orders to be executed without the participation of a dealer.

Since dark liquidity provides demonstrable benefits and efficiencies to the markets and market participants, and dark pool ATSs provide needed competition to exchanges and other market centers, we believe that the Commission first needs to establish that the current equilibrium between displayed interest and non-displayed interest (and in particular the non-displayed interested represented by ATSs) has become so unbalanced that it creates unfairness for some or all market participants in ways that are detrimental to the market as a whole. We do not believe that this has been established, and the Proposing Release is admittedly short on data in this regard.

On the other hand, if the current state of the markets really does create an unacceptable level of unfairness (and we do not believe it does), the Commission should consider broader changes to market structure to address such identified areas of unfairness. In our view, significant changes to market structure (like the curtailment of significant amounts of dark liquidity in ATSs) should not be done in a piece-meal fashion, but instead should be considered as part of a broader effort (much like occurred during the consideration and adoption of Regulation NMS). Considering all structural changes together, and receiving input from the widest range of interests possible, can help prevent unintended consequences and conflicting regulation that can end up doing harm to our markets. For this reason, we believe that the Commission too quickly issued the Proposing Release before it published and received comments on its recently-issued Concept Release, which seeks input on numerous issues related to dark pools and dark liquidity in the markets, and question whether it would be more appropriate to consider all proposed changes relating to the regulation of dark liquidity in ATSs in a single rulemaking proceeding.[16]

We believe that, if the Commission had first sought information through the Concept Release, which discusses all of the issues surrounding dark liquidity offered through ATSs and

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Commissioner Carter Beese stated that "[a]lthough proprietary trading systems still account for a small percentage of total volume in the United States, their rapid growth has shaken the established markets to their cores. The exchanges and the NASD decry what they perceive to be an inequitable regulatory system that imposes many more requirements and responsibilities on them than it does on these private sector systems." Remarks of Commissioner J. Carter Beese, Jr., U.S. Securities and Exchange Commission, "Patterns of Integration in and among International Financial Markets", Promethee/Euroclear Symposium, Brussels, Belgium, October 1, 1993. Despite the claimed loss of significant market share, however, according to the Commission's own figures in the Proposing Release, dark ATSs still only account for approximately 7.2% of trades in NMS stocks, market-wide.

[16] For instance, in balancing the competing objectives for a national market system, we believe that it is important for the Commission to understand the interactions among all of any proposed structural changes. For instance, the Commission seeks to limit dark liquidity in ATSs through the current rulemaking, but also seeks comment on other aspects of dark liquidity in the Concept Release. We believe that if the Commission is going to change the current structure of our national market system to address dark liquidity issues, it should address those issues collectively such that the national market system objectives may be applied in a more complete fashion.

other market centers, it would realize that, based on objective evidence, dark liquidity from ATSs in its current forms has not harmed the markets and the various interests between dark and light liquidity remain in equilibrium.

C. The Current Equilibrium Between Light and Dark Liquidity is Not Skewed

According to the Proposing Release, the Commission appears to be basing many of its proposed rules on the assumption that the existence and proliferation of dark ATS liquidity is harmful, and that the proposed regulations are needed to bring the markets back to a proper balance between light and dark liquidity. We disagree for several reasons.

First, dark liquidity poses no more of a threat now than it has in the past when the Commission determined that dark liquidity served an important function in the markets. In 1998, when the Commission endorsed the concept of dark liquidity in its adoption of Regulation ATS, alternative trading systems (including dark pools) handled more than twenty percent of the orders (but not executions) in securities listed on The Nasdaq Stock Market, and almost four percent of orders in exchange-listed securities.[17] Today, according to the Proposing Release, there are 29 dark pools in operation, and only 11 of those utilize some form of IOIs to which some of the proposed rules in the Proposing Release are addressed.[18] Furthermore, the trading in those 29 dark pools collectively represents just 7.2% of the total share volume in NMS stocks, with no individual dark pool exceeding 1.3% of the total share volume.[19] By contrast, the Commission noted in the Concept Release that the NYSE alone executed approximately 25.1% of the consolidated share volume of its listed stocks in October 2009.[20] In addition, if dark pools collectively account for 7.2% of total share volume executions, then non-dark pool executions constitute approximately 92.8% of the total share volume in NMS stocks. Obviously, dark ATS executions still constitute only a very small percentage of the market today, and their market shares are dwarfed by executions in the light and other markets. The Commission has consistently recognized that the decrease in the market share of exchanges is the result of numerous changes to our market structure over the years and not merely because of the proliferation of dark pools.[21]

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[17] See ATS Adopting Release, 63 FR 70845.

[18] See Proposing Release, 74 FR at 61210, n.20.

[19] See Proposing Release, 74 FR at 61209.

[20] See Concept Release, 75 FR at 3595. Interestingly, in the Proposing Release, the Commission compared the 7.2% collective figure for dark pool executions to a claimed 19% total volume of executions by a single exchange during a one-week period in September 2009. Comparing the 1.3% volume of the dark pool with the largest market share to the NYSE's 25.1%, it should be noted that the largest ATS has only about 1/20 of the NYSE's market share.

[21] See Concept Release, 75 FR at 3494-95. The Commission should be wary of claims that the current regulatory regime is 'unfair' to exchanges because they have lost market share to dark pool ATSs, that they claim are subject to less regulation; there are many reasons that exchanges have lost market share to other trading venues that have nothing to do with the amount or type of regulation over those other trading venues.

Second, the Proposing Release makes clear that the Commission believes that dark pools are an inaccessible "tier," such that smaller investors do not have access to dark liquidity. This simply is not the case. Subscribers to dark pools include institutional investors such as pension funds (often representing the interests of Main Street workers) and mutual funds (which represent retail investor interest), as well as other broker-dealers (which can be representing their smaller customers' orders). Even broker-dealers that are not direct subscribers to dark pools may have indirect access to the dark liquidity residing in those ATSs through their executing and clearing firms, which are likely to be subscribers. Broker-dealers that are subscribers to dark pools may stream their retail customer order flow through dark pools, for potential execution with the possibility for price improvement, on their way to other trading venues, such as exchanges, where those orders will be included in the public quote stream.[22] These broker-dealers also may receive IOIs from a dark pool when liquidity may be available so that they can route their customers' orders to the dark pool for possible execution and price improvement. Broker-dealers representing their retail customers' orders that don't receive IOIs may "ping" dark pools with IOC orders regularly in search of an execution. In addition, dark pools are connected to each other and to displayed markets, including exchanges, such that any investor (retail or institutional) utilizing his or her broker's smart router has access to, and can seek out, the liquidity available in any of those venues. Finally, some dark pools send IOIs directly to exchanges, and in response, those exchanges often send their customer orders to the dark pool for an execution against the dark liquidity residing in the ATS.[23] Thus, the conclusion that dark pools are inaccessible to the small investor is demonstrably false.

Third, we believe that the IOIs employed by market participants, including dark pools, add significant efficiencies to our national market system. IOIs are one solution to the fragmentation present in our current markets. IOIs signal that liquidity may be present in a particular dark pool such that there is the possibility that, if the recipient sends an order in response and if its order can be matched against that liquidity, a trade may occur. As such, these IOIs are little different than a floor broker's shout to the crowd that he may be interested in buying or selling a particular security. These IOIs are often based on larger-sized orders residing in a dark pool that are intended to be executed against contra-side interest over time so as to minimize the larger order's market footprint. The IOIs allow their recipients to route orders to a market center that is more likely to result in an execution than another of the more than 240 market centers identified by the Commission as participating in our national market system

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[22] We note, however, that while the Commission implies in the Proposing Release that dark liquidity in ATSs is not accessible by retail investors because of the actions of dark pool ATSs, the Concept Release basically acknowledges that retail order flow is not generally sent to either ATSs or exchanges in the first instance: "OTC market makers ... appear to handle a very large percentage of marketable (immediately executable) order flow of individual investors that is routed by retail brokerage firms. A review of the order routing disclosures required by Rule 606 of Regulation NMS of eight broker-dealers with significant retail customer accounts reveals that nearly 100% of their customer market orders are routed to OTC market makers. The review also indicates that most of these retail brokers either receive payment for order flow in connection with the routing of orders or are affiliated with an OTC market maker that executes the orders." See Concept Release, 75 FR at 3600 (footnotes omitted). It is evident that retail order flow is not sent directly to ATSs by retail brokerage firms not because of any problem relating to access, but because ATSs do not provide payment for order flow to those brokerage firms generating that order flow.

[23] In fact, an exchange may send an order to a dark pool in response to an IOI it has received in order to avoid having to route that order to another exchange pursuant to Regulation NMS.

today.[24] This decreases the amount of message traffic that may otherwise overwhelm the system if market participants started to "blind ping" throughout the market searching for executions.

The current system does, however, require all investors and traders to spend the time necessary to figure out the best strategy to accomplish their individual goals.[25] For example, a broker-dealer handling a retail customer market order that sends that order directly to an exchange or OTC market maker (that itself does not route orders to dark pools where appropriate) is not likely to get access to the same price improvement possibilities that it would be able to access if it either entered into an arrangement with one or more dark pools that are connected to other market centers (both light and dark) or employed the services of a smart router to comply with its best execution capabilities. Similarly, an individual investor sending a limit order for execution through an on-line broker for a small fixed fee is not likely to have the same price improvement possibilities offered by a full-service broker that may charge a higher fee. This, however, is not "unfair." There is no reason to punish those that take the time, effort and expense to seek out or provide better execution capabilities in order to "protect" the persons who do not expend the effort to seek out or provide an equivalent result or level of service.

Indeed, agency-only dark pools play an important role in maintaining market equilibrium. Agency-only brokers play a key role in helping investors and traders figure out the right investment strategy, by acting as the investors' advocate in the market. An agency-only broker is a neutral party that does not trade against its customers, and it therefore focuses its resources on working to enhance its best execution capabilities for those customers. Agency brokers have created dark pools where long-term investors can trade away from the high-frequency traders of proprietary trading firms and market makers. We note that the Commission's proposals do not take into account the important differences between ATSs in which the sponsoring broker-dealer participates on a proprietary basis in customer trades, which are more akin to market makers and specialists, and agency-only ATSs that do not participate as contra-parties to their customers' executions. While lightness and all that attaches to it may be appropriate for ATSs with proprietary trading in some areas, it is less appropriate for agency-only ATSs. These differences should be taken into account when weighing whether the proposed rules meet the national market system objectives of promoting fair competition between brokers and dealers and providing the opportunity for investors' orders to be executed without the participation of a dealer.

Despite what we see as a demonstrable lack of inherent unfairness in the current system, the Commission is contemplating making significant structural changes relating to dark liquidity.

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[24] According to the Concept Release, market centers consist of approximately 10 stock exchanges, 5 ECNs, 32 dark pools, and 200 non-ATS broker-dealers identifying themselves as market centers to FINRA. See Concept Release, 75 FR at 3497-3600. In the Proposing Release, the Commission states that there are approximately 73 ATSs that are subject to Regulation ATS (see 74 FR at 61222), and 29 of those are dark pools. Notably, the Commission's figures for transaction volume market shares in the Concept Release do not appear to include the shares of the approximately 41 ATSs that are not dark pools. If those are included in the total number of market centers, there are approximately 288 different market centers vying for order flow.

[25] See Gary Ardell and Joseph Cangemi, "Beyond Execution: the Changing Role of the Trader in a Liquidity Management Environment," A Guide to Liquidity (Institutional Investor, Fall 2007). A copy of this article is attached to this letter as Exhibit A.

Just some of the questions that will need to be answered before embarking on such a path include:

- Will the new rules simply drive liquidity away entirely, rather than drive it into the light or further into the dark?
- Will the proposed changes cause institutions to think twice before trading because their trading interest will be more transparent?
- Will this change drive the average execution size down even lower, as institutions break up their larger-sized orders even more than they do today so as to avoid showing their interest publicly?
- Will institutions consolidate their trading interest in the dark, thereby removing liquidity from the public markets that otherwise would have been available for interaction with public orders?
- Will the inevitable increase in IOC orders and fragmentation outpace the abilities of regulators to appropriately surveil the markets?

In analyzing these and other potential unintended consequences of its proposed rules, we believe that the Commission should adopt a "do no harm" philosophy. In our view, some of the Commission's specific rule proposals in the Proposing Release could lead to a result that is antithetical to what the Commission actually intends. With this as background, we respectfully submit our views on the various specific proposals in the Proposing Release.

II. The Current Proposed Rules and Their Shortcomings

A. Changing the Definitions of Bid and Offer to include "Actionable IOIs"

1. Background

According to the Proposing Release, it appears that there are approximately 73 ATSs currently registered with the Commission.[26] When those market centers are added to the number of registered stock exchanges, electronic communications networks ("ECNs") and OTC market makers, it is clear that market participants have a wide array of execution venues to which to send their orders for securities transactions for possible execution. Because of the large number of operating market centers, all buy or sell interest in a particular security is not likely to be found in a centralized location, but instead is likely to spread amongst differing market centers. Various practices have developed over the years to assist market participants in finding liquidity in the most efficient way. For instance, institutional investors may have direct access to a wide array of market centers, and can direct their orders to those markets when trading interest becomes available. Some market participants use algorithmic servers and smart routers that collect and analyze market data and route their orders to the market centers determined by those smart routers to have the highest likelihood of execution.

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[26] See Proposing Release, 74 FR at 61222. Of these, the Commission states that approximately 29 of them are considered to be "dark pools." Id., 74 FR at 61209.

Trading venues also employ methods to help ensure that buyers and sellers can find contra-side trading interest in their markets more efficiently. For example, an exchange will post quotations including the price and size of a potential trade in a security, and these quotes are widely disseminated to the markets. Some ATSs also include quotes in the public quote stream, while others utilize IOIs to show possible interest in arranging a cross against contra-side liquidity that may reside in the ATS. While there is no uniform criteria of what constitutes an IOI, an IOI traditionally does not contain all of the elements of an actual order (*e.g.*, it does not specify price or size), and so only indicates that an ATS subscriber is potentially interested in buying or selling a particular security. Currently, IOIs are expressly excluded from the definition of "bid or offer" under the Exchange Act's Regulation NMS for purposes of a broker-dealer's quotation obligations,[27] which means that IOIs sent by ATSs generally have not been required to be included in the public quote stream. According to the Commission, only 11 dark pool ATSs currently use some form of IOI.[28] Many other market participants use IOIs as well, including OTC market makers, proprietary trading desks, and agency sales traders, and there are well-established methods for widely disseminating IOIs, such as Bloomberg, Autex, and Reuters. IOIs also can be sent only to targeted market participants via direct linkages.

Unlike on an exchange, where the best posted quotation is required to be firm (*i.e.*, the quote must be honored at the displayed price up to the displayed size), IOIs generally do not reflect the promise of an execution at any particular price, but rather only indicate that a trade may be possible. The Commission, however, is concerned that when such IOIs are "actionable," they are actually more akin to quotes, and that, instead of being published to the world at large, they are being shown only to a select number of market participants. As a result, the Commission is proposing to amend the definition of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS to expressly limit its exclusion of IOIs from those terms to those IOIs "that are not actionable." As a result, "actionable IOIs" will have to be included in the public quote stream and made available to execute against by any market participant. While we understand the importance of price discovery, the current proposal to require the display of "actionable IOIs" by ATSs arguably meets only one of the five objectives for our national market system.

First, IOIs facilitate economically efficient execution of securities transactions -- they enable the recipient to direct its orders to an execution venue at which it may have a better chance of getting its order filled than through sending IOC orders serially to a multitude of venues on a blind basis. Unlike IOC blind pinging, which requires a huge amount of messaging traffic, most of which is white noise, an IOI can be deployed once, since there is no guarantee of execution associated with it. If and when a response is received, the market participant sending the IOI can decide whether to execute against the response. IOIs also enable institutional investors, to whose orders the IOIs relate, to attract contra-side interest that could lead to an execution while keeping their interest from becoming too widely known and thereby negatively affecting the prices at which their orders can be filled.

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[27] See Rule 601(b)(8) of Regulation NMS, 17 CFR § 601(b)(8).

[28] See Proposing Release, 74 FR at 61210, n.20.

Second, they help promote fair competition between ATSs and exchange markets. Even though exchanges are characterized as "light" markets, there is considerable dark interest present on exchanges in the form of hidden order types. For example, Rule 604 of Regulation NMS exempts specialists and OTC market makers from including limit orders that better the specialist's or market maker's quote from inclusion in their publicly-disseminated quotes if the customer explicitly requests that the limit orders not be displayed. Similarly, orders sent to exchanges may have significant reserve size that is not included in the displayed order size. One must question why hidden institutional interest on exchanges, which have considerably larger market shares than ATSs, is considered beneficial, but the same thing is considered harmful in connection with the 11 or so ATSs that employ IOIs. Because exchange market makers and specialists are aware of the actual undisplayed interest, they are able to take that information into account when determining their quotes, and they also are able to trade against those orders for their proprietary accounts. This is not the case with agency-only ATSs such as those operated by ConvergEx.

Third, while IOIs may not be included in the public quote stream (and we recognize that requiring their inclusion in the public quote stream will increase market transparency in some regard), they are generally available, through various means, to brokers and dealers, institutional investors, and other market centers (including exchanges) either directly or through algorithmic servers and smart routers. Unlike on exchanges, where market makers and specialists are the only recipients of hidden order information, IOIs from ATSs are more broadly disseminated, giving more market participants the opportunity to interact with the underlying liquidity. IOIs also are one of the market linkages that help alleviate market fragmentation. As discussed below, we are afraid that, if IOIs are required to be included in the public quote stream, institutional investors will move their orders further into the dark, which will have the opposite effect from what the Commission intends. Those orders will migrate to the dark in the form of blocks in order to enjoy the protections this rule proposes.

Fourth, most ATSs provide price improvement over traditional exchange executions, and IOIs that attract order flow to those ATSs therefore facilitate best execution. Because ATSs that employ IOIs are linked to numerous full-service broker-dealers and other market centers, broker-dealers seeking to execute their customers' orders in ATSs in response to IOIs are able to do so without significant practical difficulty. We do recognize that ATS orders are not universally available to non-subscribers, but we also note that only broker-dealers that are members of an exchange can send orders to that exchange, and that non-members must send their orders to a member firm in order to access the exchange.

Finally, IOIs from ATSs facilitate the opportunity for investor orders to be executed without the participation of a dealer. This is particularly true for agency-only ATSs employing IOIs. An institutional investor may submit a resting order to the ATS, and the IOIs that are sent out by the ATS relating to that order can attract a steady stream of contra-side order flow that will execute against the resting order. No dealer participation, with its attendant costs in terms of execution fees and information leakage, is required.

Consequently, we believe that ATS IOIs, whether actionable or not, are generally beneficial to the efficient working of our national market system, and are not unfairly harmful to

any particular market constituency. Nevertheless, if the Commission is still determined to more fully regulate the use of IOIs by ATSs, we have the following concerns about several aspects of the proposed rules.

2. "Actionable IOI" Should be Defined in a Rule

The Commission describes what it means by the term "actionable IOI" in the Proposing Release as follows:

> an IOI would be considered actionable under the proposal if it explicitly or implicitly conveys all of the following information about available trading interest at the IOI sender: (1) symbol; (2) side (buy or sell); (3) a price that is equal to or better than the NBBO (the national best bid for buy orders and the national best offer for sell orders); and (4) a size that is at least equal to one round lot. In determining whether or not an IOI conveys this information, all of the facts and circumstances surrounding the IOI should be considered, including the course of dealing between the IOI sender and the IOI recipient.[29]

This definition, however, has not been proposed to be included in any rule or regulation. Instead, the Commission has indicated that it may "define" the term "actionable IOI" through guidance provided in published sources such as the Proposing Release and subsequent Commission or staff guidance.[30]

Contrary to the Commission's apparent view that providing a definition through a combination of formal and informal guidance is sufficient, we believe that the better course would be to define the term "actionable IOI" in an actual rule. The definition of "bid or offer," whether or not it will exclude "actionable IOIs," is a key provision of Regulation NMS, since many regulatory obligations of brokers and dealers depend on whether a particular message sent is considered a bid, offer, indication of interest or order. Defining the term "actionable IOI" in a rule will provide more legal certainty to market participants, and will make the concept of "actionable IOI" less subject to *post hoc* interpretation by regulators through compliance examination or enforcement action. If the term is not defined in a rule, but will be defined only through less formal means such as a Commission statement or staff interpretation, it will not be subject to the checks and balances of notice-and-comment rulemaking that help ensure that proposed future rule amendments are given full consideration by the Commission itself and meet all legal requirements for such amendments.

The reason for these requirements is to ensure that industry participants are on notice of how they must conduct themselves. Defining important terms outside of rules themselves may cause confusion among persons seeking guidance as to their meaning. In this regard, instead of looking to a single source (*e.g.*, the definitions contained in Regulation NMS) for the definition

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[29] Proposing Release, 74 FR at 61212.

[30] Members of the Commission and its staff made statements to this effect during the Open Meeting at which the Proposing Release was considered.

of "actionable IOI," an industry participant would need to know that there was separate published guidance (not likely to be referenced in a standard compilation of the federal securities laws and rules) describing what was intended by the term. Even published guidance can become obsolete through staff interpretations with little or no advance notice. If a person does obtain a copy of such informal guidance, there may be no way to assure that person that what he is reading is the most recent pronouncement on the topic and is therefore still valid. Defining the term "actionable IOI" in a rule would help alleviate the guess-work that some persons may face when trying to determine what it means.

3. The Commission's Proposed Definition is Overly Broad and Vague

While we believe the term "actionable IOI" should be defined in a rule, we also believe that the Commission's proposed definition as set forth in the text of the Proposing Release is overly broad and too vague. We agree that, to be considered a quote for quotation rule purposes, a bid or offer should contain each of these elements of a trade: symbol, side, price, and size. The Commission's proposed definition, however, may not actually require either actual size or actual price to be specified. Regarding price, the Commission's proposed definition would hold that an indication would be "priced" if it has a price that is "equal to or better than the NBBO." Does the Commission intend that, for an IOI to be priced, the IOI would need to specify an actual stated or calculable price that is at or within the NBBO, or that the IOI would merely have to reflect an order that would be priced at or within the NBBO? Because all market centers, including ATSs, are required under Regulation NMS to execute all trades at or within the NBBO spread, every IOI sent to any recipient could be deemed to be "priced" under the broader interpretation of Commission's proposed definition. If this is what the Commission intends, it should clearly state it.

Similarly, the Commission's proposed definition would hold that an indication would be "sized" if it has a size that is "at least equal to one round lot." Since most, if not all, market centers, including ATSs, execute trades of at least 100 shares (and do not execute odd lots), under a broad interpretation of this part of the definition – *i.e.*, any IOI reflecting a possible size of at least 100 shares – every indication sent to any recipient by an ATS would be considered "sized." If by "size," the Commission means that an actual size of the underlying order (which could be 100, 500, 5,000 or any number of shares) must be reflected in the IOI for it to meet this element, however, the Commission's definition should reflect that.

If the Commission actually intended to "define" size and price as broadly as contemplated above, the only two elements that could possibly differentiate an IOI (which would still be permissible and not subject to public display) from an "actionable IOI" would be symbol and side. The Commission, however, also says that the four required elements may be express or implied, and that determining whether all of the elements are present involves a facts-and-circumstances analysis, including the course of dealing between the ATS and the recipient of the IOI.[31] As a result, depending on the facts and circumstances of the ATS at issue, even symbol and side could be implied. For instance, if an ATS does not specify side in the IOIs it sends out, but it only sends out IOIs when it has sell interest residing in the ATS, would those IOIs

[31] Proposing Release, 74 FR at 61212.

implicitly denote side (even if the recipient was not aware of that convention)? Similarly, if a particular ATS is an OTC market maker in a particular NMS stock or group of stocks, and its IOIs more often than not relate to those stocks, would symbol be implied in IOIs sent out by that ATS?

Worse still is the fact that, due to the breadth of the proposed definition and the retroactive nature of the proposed analysis, an IOI that was reasonably thought not to be actionable at the time it was sent could subsequently be found by a regulator to have been actionable at the time it was sent. For example, say that an ATS sends out IOIs without a side specified reflecting all interest (buy or sell) residing in the ATS, but it is later determined that most of the IOIs sent out reflected sell interest residing in the ATS. Under the Commission's broad proposed definition, it could be argued, in hindsight, that those IOIs would imply the side. Thus, the Commission's proposed gloss and additional caveats – the required elements can be express or implied, based on facts-and-circumstances, and determined after the fact based on a course of conduct between the ATS and the recipient – make the definition of "actionable IOI" much too vague for effective compliance. By keeping the definition vague and making the application of the definition retroactive, the Commission is holding ATSs to an impossible legal standard. We therefore urge the Commission to adopt, in a rule, a definition of "actionable IOI" that provides clear guidance to industry participants and regulatory staff alike as to the messages that will be included in that definition and those that will remain outside of that definition.

4. The Commission Should Make Clear that an SOI is Not an Actionable IOI

When the Commission clarifies and codifies its definition of "actionable IOI," it should also make clear that a "solicitation of interest" ("SOI") is not covered by that definition. As noted above, the Commission views an actionable IOI as containing, explicitly or implicitly, the four elements of symbol, side, size and price. By contrast, an SOI does not contain all four elements – it does not identify the side or size of an order, nor does it specify a price.[32] It only contains a symbol. Some exchanges send SOIs to other market centers to reflect the fact that there is a pending order in a particular security at that exchange.[33] Since the Commission has already approved SOIs from exchanges as appropriate and not subject to separate quotation obligations, the Commission should similarly exclude SOIs that merely contain a symbol reflecting interest in that security residing in an ATS from the definition of an "actionable IOI."

We note that, if SOIs only denote security symbol, over time they should reflect either buy interest or sell interest approximately fifty percent of the time. Since an ATS cannot control the side of the orders submitted by its subscribers, however, it is possible that IOIs will reflect orders to sell more often than orders to buy, or vice-versa, during any particular period. It would be useful for the Commission to provide a benchmark by which an ATS may determine whether its SOIs fall outside of the adopted definition. For example, the Commission could say that if an ATS's SOIs result in the recipient of an SOI executing an order to buy (or sell) more than 75%

[32] See, e.g., Release No. 34-54528 (Sept. 28, 2006), File No. SR-ISE-2006-48.

[33] See ISE Rule 2129(d)(2).

over a particular period of time, the SOI will be deemed to indicate side. In that case, if, as noted above, the price and size are always implied in any IOI, the SOI would be converted into an actionable IOI. Such clear standards will enable ATSs (and other market participants that use IOIs) to program their electronic systems appropriately.

5. The Proposals May Do More Harm than Good

Because the proposed definition of actionable IOI is so broad, certain ATSs likely will start to include their best orders in the public quote stream, in accordance with the Commission's expressed intent. Other ATSs, however, will choose or be forced to go completely dark. In some cases, the institutional customers of an ATS may demand that the ATS remain dark in order to protect those institutional customers from the information leakage that occurs in a light market. Still other ATSs may not be able to publish actionable IOIs even if they wanted to do so. This would be the case with any ATS that prices its transactions derivatively from the NBBO (*e.g.*, at the NBB, the NBO, or the midpoint) so that the price reflected in the IOI would always change with a change in the NBBO. In fact, apart from the fact that there would not be a set price to be quoted for their orders, midpoint crossing networks would not be allowed to publish quotations reflecting orders residing within their systems since, among other reasons, their best bids and offers, if published, would lock the market. They have no choice but to go completely dark.

To the extent that a number of ATSs become fully dark and stop distributing IOIs to anyone, the Commission's proposals would actually result in decreased, not increased, transparency. In addition, the amount of message traffic within trading systems will increase as seekers of liquidity send more IOCs randomly to dark market centers throughout the marketplace hoping to find such liquidity. This in turn will result in an increased surveillance burden on regulators such as FINRA, which tracks orders, executions and cancellations through OATS. Thus, the Commission's proposals could have the opposite effect from what it intends.

6. The Exclusion for Large Size Orders from the Definition of "Actionable IOI" Could Result in Unintended Consequences

The Commission has proposed an exception from the definition of "bid" or "offer" for IOIs representing a quantity of an NMS stock with a market value of at least $200,000 that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000. As a result, IOIs shown to participants in ATSs that cater exclusively to institutions engaged in block trading would not trigger quote obligations. According to the Commission, these block crossing networks offer significant size discovery benefits (*e.g.*, finding contra-side trading interest while minimizing market footprint) that would be lost if the underlying interest was required to become part of the public quote stream.

We note, however, that, if it does adopt a block exception for IOIs, the Commission will be encouraging investors with block-size interest to consolidate their trading interest in the dark. Currently, investors with block-size interest may utilize a combination of block-crossing networks, dark pools and light markets for their executions. With a very large order, rarely would an investor send the entirety of the order to a single market center for execution. Instead, the investor is likely to employ an algorithmic server to slice up that larger order and send the

different pieces to different market centers for execution in an attempt to disguise its full interest. Those servers rely on quotes, IOIs and SOIs in the light markets and IOIs from dark pools when splitting the larger orders apart and routing them for execution throughout the market. Current usage of algorithmic servers therefore allows for at least some transparency in the light markets relating to that block-size interest. To the extent that orders sent by algorithmic servers to light markets and dark pools will have to be displayed, but larger orders sent to block crossing networks will not be displayed, it is likely that institutions with block-size interest will consolidate their interest and send a much higher percentage of their large-sized orders to block crossing networks, and will forego sending at least some of their interest to the light markets. This will result in a diminution of transparency and liquidity in the light markets.

It is also possible that institutions would engage in less total trading if their choices for large executions are (1) submit those large orders to light markets, dark pools using IOIs, or brokerage trading desks with the attendant display requirements and information leakage problems; (2) submit the large-sized order to a dark pool without IOIs and hope that contra-side interest finds it there by happenstance at some point in the day (not particularly efficient); or (3) conduct more trades in block-crossing networks, which are generally more expensive than other trading venues and may provide a worse all-in price than ATSs that provide for smaller executions of larger parent orders over time. None of these is a particularly appealing choice.

B. The Display Threshold of Regulation ATS Should be Lowered To 1% of ADTV

In the Proposing Release, the Commission has proposed to lower substantially – from 5% of the ADTV to 0.25% of the ADTV of the particular stock – the trading volume threshold in Regulation ATS that triggers the public display requirement for orders and actionable IOIs shown to more than one person by an ATS. According to the Commission, lowering the threshold to this level will reduce the potential for two-tiered markets and improve the quality of quotation data made available to the public. In its view, this amendment will create a more level playing field with respect to order display and execution access for all market participants that receive and attempt to execute orders, including exchanges, ATSs and OTC market makers.

The Commission's proposed amendment, however, would actually create a tiered playing field between ATSs and OTC market makers, which currently are required to include their best orders for NMS stocks in the public quote stream if they have 1% or more of the ADTV of an NMS stock in the most recent calendar quarter.[34] Consequently, at the very least, we ask the Commission to modify its proposed amendment of the display threshold in Rule 301(b)(3) of Regulation ATS to require such display if the ATS has 1%, rather than 0.25%, of the ADTV of an NMS stock in 4 of the preceding 6 months.

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[34] We note, however, that OTC market makers, like exchange specialists and market makers, hold themselves out (by entering quotes into an interdealer quotation system or otherwise) as willing to buy or sell a security for its own account on a regular or continuous basis. See Exchange Act Section 3(a)(38) (definition of "market maker"). ATSs, particularly ATSs like those operated by ConvergEx that match customer orders on an agency cross basis, do not hold themselves out as market makers.

The Commission should note, however, that decreasing the current threshold level of 5% of the ADTV in any NMS stock to even 1%, let alone 0.25%, could cause institutional investors that currently utilize dark pool ATSs to change how they handle their large-sized, but not block-sized, orders. If orders sent to ATSs are required to be displayed at such a low threshold (and resulting trades are required to be reported with ATS attribution on a real-time basis, discussed below), it is likely that institutional investors that value the safeguarding of their order information and seek to avoid the market impact of a displayed order would send their orders of any appreciable size to completely dark ATSs, which will contribute to decreased transparency. In addition, to avoid a broader public display, such institutional investors may have to revert to utilizing broker-dealer block trading desks outside of ATSs to handle orders of significant size but that do not meet the Commission's definition of a 'block order' for purposes of the proposed amendments even though some information leakage is likely to occur if they do so. Alternatively, they would likely chop up their larger-sized orders into much smaller pieces and disperse them throughout the market to disguise their total interest, thereby adding to fragmentation. We believe that the status quo may serve the markets better.

C. The Commission Should Not Require Real-time Trade Reporting with ATS Attribution

1. End-of-Day Attribution Meets the Commission's Goals Without Harming ATSs and their Customers

Instead of maintaining the current system for the publication of trade reports, in which published trade reports for trades executed in ATSs are identified only as OTC trades, the Commission is proposing to require real-time disclosure of the identity of the executing ATS on the trade reports of their executed trades. One justification given by the Commission for this requirement is that trade reports for executions on exchanges identify the exchange, and because both exchanges and ATSs "bring together orders of multiple buyers and sellers on an agency basis," their trade reporting should therefore be "equalized."[35] The Commission believes that the increased transparency that will result from real-time reporting of ATS trades with attribution will make it easier for the public to find available liquidity and will "reduce the 'information gap' between investors with differing degrees of sophistication."[36] Among other things, the Commission believes this will "increase the perception of fairness ... [and] enhance public confidence in the securities markets."[37] It is this proposal that may do the greatest harm to the current market equilibrium.

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[35] Proposing Release, 74 FR at 61219. This conclusion is contrary to its historical finding that ATSs and exchanges perform different functions in our national market system and should be treated differently.

[36] Proposing Release, 74 FR at 61219. We note that the Commission justifies this proposed requirement in the Proposing Release by noting that "approximately 38 percent of trading volume in NMS stocks is reported as OTC (which includes ATS trades)." Id. This number is misleading – as the Commission already indicated, ATSs account for only 7.2% of trading volume in NMS stocks. Consequently, using the Commission's figures, even if ATS trades are identified by the particular ATS executing the trade, approximately 30.8% of trades in NMS stocks will be reported as OTC.

[37] Proposing Release, 74 FR at 61220.

In adopting Regulation ATS in 1998, the Commission stated the following, which remains true today:

> [T]he Commission believes that the continued ability of institutions to retain their anonymity and to use features within alternative trading systems to shield the full size of their orders gives institutions the ability to keep their full trading interest private. The Commission recognizes that anonymity is often important to institutional investors so that when they are unwinding or building security holdings they do not signal their trading strategy and negatively impact their own market position.[38]

Contrary to this view, however, the Commission's current proposal requiring real-time trade reporting with ATS attribution could signal institutional investor trading strategies and negatively impact their market positions.

While we understand the need for transparency, we believe that the Commission's proposal goes too far – transparency can be enhanced while protecting legitimate trading interests even where the identity of the executing ATS is not published in real time. We note that the Commission itself stated in the Proposing Release that "one of the most important functions [the Commission] can perform for investors is to ensure that they have access to the information they need to protect and further their own interests."[39] By singling out ATSs (and only some of them because of the block trade exemption) for real-time attribution in trade reports, however, the Commission's proposals may allow some market participants (such as proprietary traders) to further their interests at the expense of other market participants (such as institutional investors using dark pool ATSs to minimize their market footprint). The interests of all market participants can be more appropriately balanced if the current system of publishing post-trade reports from ATSs as OTC trades on a real-time basis is maintained, and a new requirement to publish, for each individual ATS, the total trading volume of each NMS stock traded on that ATS at the end of the trading day, is adopted. This will meet the Commission's goal of enhanced transparency while minimizing the damage to the interests of institutional investors utilizing ATSs.

In this regard, providing the identity of the ATS in which a trade has just been executed gives away too much information to the detriment of institutional investors trying to get their larger-sized orders executed. Different ATSs tend to have different types of clients, and some may be known for executing trades in certain stocks or types of stocks more often than other ATSs. By attributing a trade report to a particular ATS in real time on the consolidated tape, another market participant may be able to surmise the identity of the buyers and sellers in those trades. (By contrast, because of the wide range of possible counterparties to an exchange

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[38] ATS Adopting Release, 63 FR at 70866.

[39] Proposing Release, 74 FR at 61219.

execution, an exchange trade report provides less identifying information.[40]) It can then use that information to trade against those institutional investors at a favorable price or enter into transactions in other markets in those same stocks that will affect the execution price in the ATS. Traders could use that information anticipatorily in connection with momentum-based trading strategies. Similarly, high-frequency traders and other market participants with the fastest technology would be able to digest that trade location information to either place trades in other markets to affect the prices in the ATS and/or access potential liquidity in the ATS before other market participants.[41] All of these things will result in higher trading costs for institutional investors, precisely the long-term investors the Commission forcefully seeks to protect.[42]

One reason cited by the Commission for requiring real time attribution of ATS reported trades is that trading volume statistics regarding trades of individual stocks in ATSs will be easier to calculate and more reliable. That goal, however, can be just as easily accomplished by the assignment to each ATS of a unique identifier (separate and distinct from that of its sponsoring broker-dealer) and the publication, at the end of the trading day, of the identity of the ATS and the trading volume in each stock it has traded that day. Regulators can easily use this information to confirm the reports of the quarterly trading volumes by ATSs on Form ATS-R.[43] Furthermore, broker-dealers and other market participants can utilize this end-of-day information, together with the order execution information that ATSs and all other market centers are required to publish pursuant to Regulation NMS on a monthly or quarterly basis, in

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[40] As the Commission points out, the public is made aware of the exchange upon which an exchange trade was executed in the consolidated tape. That trade report, however, does not give any information as to the identity of the type of customer whose orders were executed – at most, one will know that the trade involved a broker-dealer because only broker-dealer members of an exchange may send orders to that exchange. One cannot tell whether an exchange-reported trade involved a retail customer order or institutional customer order represented by a broker-dealer, a broker-dealer proprietary order, or specialist participation in the trade. Even if someone other than the exchange specialist can surmise the identity of the broker-dealer exchange member representing the exchange execution, it is impossible to tell from these trade reports whether that member firm involved in a trade was representing itself or was representing a retail customer, an institutional customer or another broker-dealer. Thus, the information that can be gleaned from an exchange-sourced trade report is less valuable than that which could be discerned from the identity of the ATS on which a trade was executed.

[41] This is likely to result in a two-tiered market based on who has the fastest technology.

[42] See Concept Release, 75 FR at 3603; SEC Release No. 34-60684 (Sept. 18, 2009), 74 FR 48632, 48635-36 (Sept. 23, 2009) ("Flash Order Proposal").

[43] In this regard, we note that FINRA has recently proposed to collect, but not disseminate publicly, trade reports of executed trades in certain asset-backed securities ("ABS"). See SEC Release No. 34-60860, File No. SR-FINRA-2009-065 (Oct. 21, 2009), 74 FR 55600 (Oct. 28, 2009). According to FINRA, "the reporting of [ABS] to TRACE will permit FINRA to obtain additional transaction information and observe patterns of trading, facilitating the oversight and regulation of the [ABS] market. FINRA will study the reported data to determine the volume and trading in various types of ABS." Furthermore, while FINRA indicated in its Proposed Rule Change that it generally favors transparency of trade report information, it does not intend to mandate publication of the trade reports for those securities until it has had an opportunity to review data over a period of time, after which it may determine that dissemination of some transaction information for ABS is warranted. Id., 74 FR at 55601. The Commission should take a similarly cautioned approach before it mandates a wholesale change that could damage ATSs in particular and the markets generally.

conducting their best execution reviews for the handling of orders entrusted to them. End-of-day attribution meets the Commission's goals while minimizing harm to ATSs and their customers.

In addition, as noted above, the Commission concludes in the Proposing Release that all ATSs and exchanges are similar in that they "bring together orders of multiple buyers and sellers on an agency basis," so that they should all have the same trade reporting requirements.[44] Just as not all exchange executions involve agency crosses because of the participation of exchange specialists in some executions, not all ATSs execute their trades solely on an agency cross basis. It is well-known that the broker-dealer sponsors of certain ATSs participate in the ATS on a principal basis.

Furthermore, requiring the real-time reporting of ATS executions with attribution could more negatively affect agency-only ATSs whose sponsoring brokers do not have a proprietary trading desk or affiliated broker-dealer to take one side of a trade. ATSs in which the sponsoring broker-dealer trades as principal against the order flow are able to execute customer orders against their internal trading desks, which, if the name of the ATS is published in the tape, could enable that ATS to appear as if it had available liquidity in an NMS stock when it actually does not. (Unlike agency-only ATSs, those internalizing ATSs can ensure that their names hit the tape often by executing small orders against their proprietary orders.) Because algorithms and smart routers will use past trades as a potential reflection of current interest, they will then route orders first to those ATSs that have been identified with a particular stock on the consolidated tape, when in fact, larger amounts of trading volume may be available at other venues, such as an agency-only ATS. If smart routers habitually send orders to those proprietary trading ATSs first, institutional investors and sell-side clients may stop sending their orders to agency-only ATSs and instead send their orders to the proprietary-trading ATSs that appear more on the consolidated tape, because they will be concerned about meeting their best execution obligations. Real-time ATS trade reporting with attribution, therefore, could benefit those ATSs operated by large retail brokerage firms at the expense of agency-only ATSs. On the other hand, end-of day ATS attribution by trade volume for each stock traded, which would provide considerable transparency, will not potentially harm the agency-only ATS business model. It also will prevent other ATSs from tipping the system in their favor by executing small orders as principal because there would be less incentive to take those small trades into their proprietary accounts.

For the reasons listed above, we do not believe that a rule requiring real-time ATS trade reporting with attribution should be adopted. Instead, end-of-day attribution for trades on ATSs would enable the Commission and other regulators to monitor and calculate the trading volume in those ATSs while at the same time protect the interests of those market participants choosing to operate completely in the dark in order to minimize information leakage and market footprint for their institutional orders.

In this connection, requiring ATSs to report trades with attribution in real time will impose costs on the industry, both in terms of computer programming costs and on-going support burdens. On the other hand, we note that the NYSE and Nasdaq each offer a service to their members under which end-of-day statistics of ATS volumes for trades reported to the respective Trade Reporting Facilities of each SRO will be separately published. These services

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[44] Proposing Release, 74 FR at 61219.

are optional and are free of charge. We believe that these services should be sufficient to meet the Commission's goals of collecting accurate ATS execution volume information and providing information to investors regarding the venues at which orders may be executed. The Commission should explicitly endorse the SROs' programs, which will make the proposed amendment of the joint-industry plans unnecessary. If, after these end-of-day reporting programs have been in place for a sufficient period, and the Commission has analyzed the data received in connection with these programs, the Commission believes that more disclosure of ATS trade information is still needed, it can revisit the issue at that time.

2. No Exclusions from ATS Trade-Reporting Requirements Should Be Given to Large Size Trades.

The Commission also proposes to exclude from the ATS attribution requirement trade reports of large size trades (i.e., those with a value of $200,000 or more). In proposing this exclusion, the Commission stated that it is sensitive to the need of investors executing large size trades to control the information flow concerning their transactions, and that requiring such large size trades to be reported with attribution on a real-time basis could cause "undue information leakage" about that trading.[45] According to the Commission, identification in a large size trade report of an ATS that focuses on block trading

> could signal to the market that the entity trading may plan to execute more trades in the same securities, with the risk that other market participants may attempt to take advantage of this information, to the detriment of the entity engaged in those large trades. [46]

The same could be said, however, for any reported trade by any ATS, even if it does not meet the Commission's proposed definition of a "large size order." There is no reason to protect the fact of an execution of $200,000 worth of a stock from the public markets, while not protecting a trade worth $190,000 (or some other figure) from disclosure. Both trades may signal that additional liquidity is available – but only in regard to the latter will the public be aware of the location of that trade so they can attempt to access additional liquidity by directing orders to that same venue. In fact, there may be less reason to protect trade reports by block crossing systems from publication than to protect trade reports by other ATSs. In this regard, high frequency traders and other market participants that seek to benefit from momentary price disparities between trading venues do not often participate in block size trades. Consequently, those short-term traders would not be able to access any potentially available liquidity in a block crossing network after a trade in that network was reported, while institutional investors utilizing other ATSs without the exemption could end up as targets of those short-term traders.

Furthermore, as noted above, a likely result from the Commission's proposed rule to require ATSs to publicly display their IOIs will be increased trading of block-size interest through blocks subject to the exemptions, rather than through the use of algorithms that split

[45] Proposing Release, 74 FR at 61219.

[46] Id.

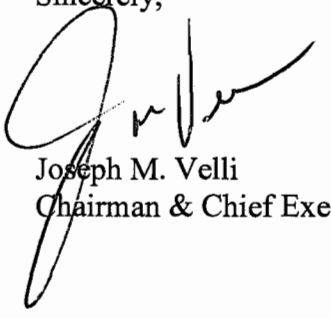
block-size orders into smaller pieces and send them to both light and dark markets. The increased use of block crossing and the decreased use of algorithms will draw liquidity away from the displayed markets. The exemption from real-time reporting of trades with attribution for block-size orders, then, is likely to result in even less liquidity and price transparency than exists in the markets now. That would be harmful to all market participants other than the institutions trading in block size. Because we believe that this is antithetical to the Commission's stated intent of enhancing price and liquidity transparency, the Commission logically should not adopt the exemption for reporting of block-size trades in ATSs with attribution. However, the Commission has already determined that not having such an exemption would harm institutional investors. Since it cannot be both ways, the Commission should abandon entirely its proposed requirement that any ATS trades must be reported in real time with attribution, and utilize end-of-day reporting, as suggested above. Indeed, with end-of-day reporting as proposed above, there is no need for the block exemption.

If the Commission does, however, determine to adopt an exclusion for block trades, in whatever form, it should adopt a definition for block trade that is consistent throughout the federal securities laws and rules.[47]

* * *

ConvergEx sincerely appreciates the opportunity to shares its views on the proposed rule amendments relating to ATSs, as well as on broader market structure issues discussed above, and would welcome the opportunity to discuss our comments with the Commission. If you have any questions on our comment letter, please feel free to contact ConvergEx's general counsel, Lee A. Schneider, directly at (212) 468-7767.

Sincerely,



Joseph M. Velli
Chairman & Chief Executive Officer

cc: The Honorable Mary L. Schapiro
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
U.S. Securities and Exchange Commission

[47] This would include the proposed exemption from the publication requirement for IOIs representing block size interest, discussed above.

Beyond Execution: *The Changing Role of the Trader in a Liquidity Management Environment*

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Recent and rapid changes in securities trading have led to increased fragmentation in the marketplace. To compete effectively in today's environment, buy-side traders must play a broader role than they have in the past. Traders today must go beyond execution to identify, access, and manage deep and diverse sources of liquidity to achieve the best overall results for their clients. Successful traders have adapted to this new environment by becoming skillful liquidity managers, leveraging the increasing number of sophisticated liquidity management tools and technologies to help maximize their total performance, respond to shifting market structure challenges, and meet their objectives while streamlining workflow efficiency.

BASIC INVESTMENT OBJECTIVES

Within this sea change in technologies and trading practices, basic investment objectives have remained constant. What has changed dramatically is the environment in which a trader transacts and executes. To achieve the best possible investment objectives today, traders must have knowledge of, as well as the ability to manage, available liquidity. This involves not only taking advantage of the sophisticated liquidity management technologies being developed and disseminated on a continual basis, but also mastering them effectively in a complex global marketplace.

Successful traders are looking for tools to help them access more dark liquidity, reduce market impact, and minimize exposure. Optimal liquidity management offerings include a range of sophisticated technologies—crossing engines, dark pools, sophisticated algorithms, advanced direct market access tools, innovative execution management systems, and performance measurement technology. Taken together, these components enable traders to have more choice and control over their execution strategies while addressing cost, timing, performance, and market structure requirements.

AN EVOLVING TRADING MARKETPLACE

Before the advent of electronic communication networks (ECNs) and other ATSs, the vast majority of trading volume took place manually on the floor of traditional stock exchanges, such as the New York Stock Exchange (NYSE). As the speed, efficiencies, and cost savings of electronic trading became apparent, trading moved increasingly off the exchange floor. Today, there are two major stock exchanges in the United States: The NYSE and NASDAQ. The American Stock Exchange (AMEX), National Stock Exchange, Chicago Stock Exchange, ISE, Chicago Board Equity Exchange and Philadelphia Stock Exchange are all competing to be number

three. The NYSE and the AMEX are the only floor exchanges; the others are electronic. Floor brokers now handle only 10% of NYSE-traded volume; all the rest is electronic.

Until just two years ago, the NYSE maintained its long-standing market share of about 80% of trading in NYSE-listed stocks. Since then, dark pools and crossing networks have proliferated, causing the NYSE's share of trading in its own listed stocks to drop to less than 50%.

This extraordinary change in trading practices is one of the driving forces behind the increase in liquidity fragmentation, particularly over the past few years. In this environment, the science of liquidity management has become increasingly complex, quantitatively oriented, and computer driven. Intelligent, focused traders, however, remain the critical factor in a successful liquidity management equation.

LIQUIDITY MANAGEMENT: THE NEW BEST EXECUTION PARADIGM

Today, best execution depends on the ability to access deep sources of liquidity while adding performance, value, and cost efficiency to transactions. A key component for achieving this new paradigm is algorithmic trading, which currently is used to generate one-third of all trading activity in the U.S. and 40% of trades on the London Stock Exchange. The most advanced algorithmic strategies dynamically adapt to market trends, enabling the trader to be more productive, have more control over execution choices, and connect with other liquidity management technologies, such as dark pools and crossing engines, to optimize performance.

Today's sophisticated algorithms can be used to slice large orders into smaller sizes, often with the intention of hiding the size of these large orders from other market participants—a technique known as "iceberging." For momentum investors, "participating" algorithms can be used to ensure that a certain percentage of trading volume in a particular stock is captured. "Benchmark" algorithms can be used to achieve specific benchmarks such as the volume weighted average price (VWAP) or time weighted average price (TWAP) over a certain time period. An algorithm may trigger a buy order on a certain percentage upward movement in a share price. Trades can be driven when the spread between two stocks exceeds a certain amount, and they can even be generated by news events. Quantifiable events such as a company's sales, net profit, or earnings per share can be e-mailed automatically in XML (extensible mark-up language) with tags around particular figures so those figures can be read by algorithms and instantaneously translated into stock trading orders.

As the use of algorithms grows, trading is becoming faster and more frequent. Daily trading volume has increased exponentially, and constant stock-price volatility has become a way of life. Product development continues to accelerate as algorithms are developed to accommodate a wide array of long and short strategies, multi-asset investment portfolios, and the use of interest rate, currency, commodity, and credit derivatives. The next wave of algorithms will prove to be even more sophisticated and trader focused, with such advanced features as embedded dark pool seeking technology, true global reach, and more precise specialization for individual execution strategies.

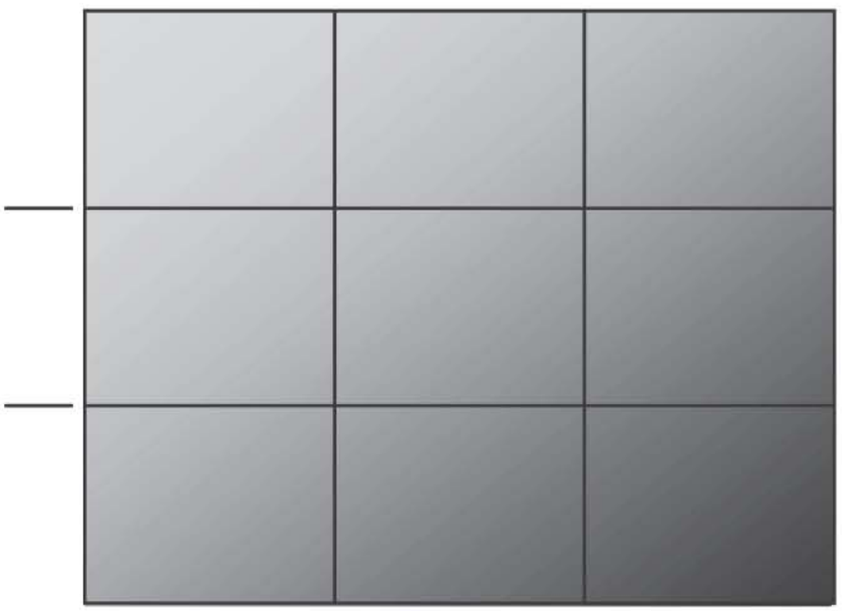
DARK POOLS: UPPING THE LIQUIDITY MANAGEMENT ANTE

In many ways, algorithms are the answer to the question, "How can a trader do institutional size in markets optimized for retail trading?" With the evolution of the markets, often the best way to work a one million share order is by doing a few hundred shares at a time. Big computers and trading algorithms make this possible. However, it is useful to remember that, ultimately, this is a little like digging a swimming pool one shovel full at a time—it is easy to arrive at the thought that there has got to be a better way. For this reason dark pools were born. The dream is to match natural order with a natural contra order in the dark, without information leakage, gaming, or market impact. Not surprisingly, the reality is somewhat more complicated.

WHO NEEDS DARK LIQUIDITY—AND WHEN

Many trading situations do not call for dark liquidity. Others virtually demand it. As we can see in Exhibit 1, whether dark liquidity is needed depends on whether the trader is dealing with large cap, medium cap, or small cap stocks (vertical axis), and the portion of average daily trading volume (ADV) that the trader is trying to buy or sell (horizontal axis). In the upper left, where the trader is dealing with large cap stocks and not buying or selling more than 5% of ADV, the open markets are perfectly satisfactory. Dark pools are not needed. But at the opposite end of the spectrum, where investors are trading small and medium cap

EXHIBIT 1



stocks, where spreads are much wider and an order might demand a large portion of ADV, dark pools are essential.

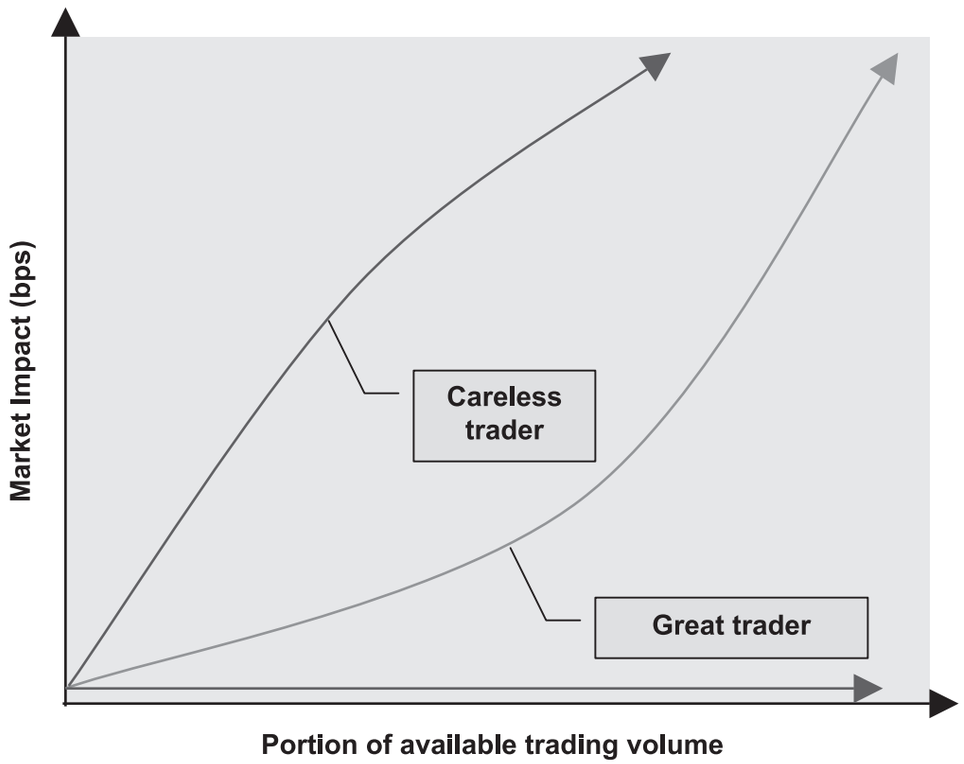
UNDERSTANDING THE VALUE OF A GREAT TRADER

Next, traders should appreciate the value of accessing liquidity well. Exhibit 2 illustrates the difference in performance between a great trader and a careless trader in terms of market impact, measured in basis points. Market impact is shown on the vertical axis and the portion of ADV that the trader is buying or selling is shown on the horizontal axis. Both the great trader and the careless trader may be able to buy just 1,000 shares at the offer price and both will have to pay an increasing premium as the amounts they try to buy increase, but as those amounts grow larger, the disparity in performance between the two traders becomes apparent. Great traders know which exchanges are geared to higher institutional rather than retail volume and how to check for liquidity in dark pools, and therefore they minimize market impact as the volume they buy increases. Careless traders, who don't know very much about how to prioritize and poll the various liquidity pools, tend to pay a higher premium over the offer price sooner as they try to buy more shares. In contrast, we see the ideal situation represented by the bottom arrow, hovering just above the horizontal axis, where the trader encounters fortuitous market conditions such as a counterparty with a huge natural block and is able to execute a large trade with no market impact at all.

UNDERSTANDING THE VALUE OF DARK LIQUIDITY

Exhibit 3 helps the trader further understand the value of dark liquidity, with market impact on the vertical axis and the portion of ADV traded on the horizontal axis. We compare the trader's results, in terms of market impact measured in basis points, among three hypothetical situations: trading in the open market, trading in the open market but also having access to dark pool liquidity, and finding a natural block cross. In the open market, the trader will pay a premium that grows at an increasing rate as the amount he is buying increases as a percentage of ADV. If he learns how to poll some sources of dark liquidity as part of his trading routine, with a little luck and skill his performance will

EXHIBIT 2



Market impact curves are for illustration only and do not represent actual data.

improve and he will be able to purchase increasing volume with somewhat less market impact. Then, if he is lucky, in one of those dark pools he will find a large block of natural liquidity and execute a significant trade with minimal market impact or none at all. Luck, of course, comes more readily to the skillful liquidity manager.

ALL DARK LIQUIDITY IS NOT CREATED EQUAL

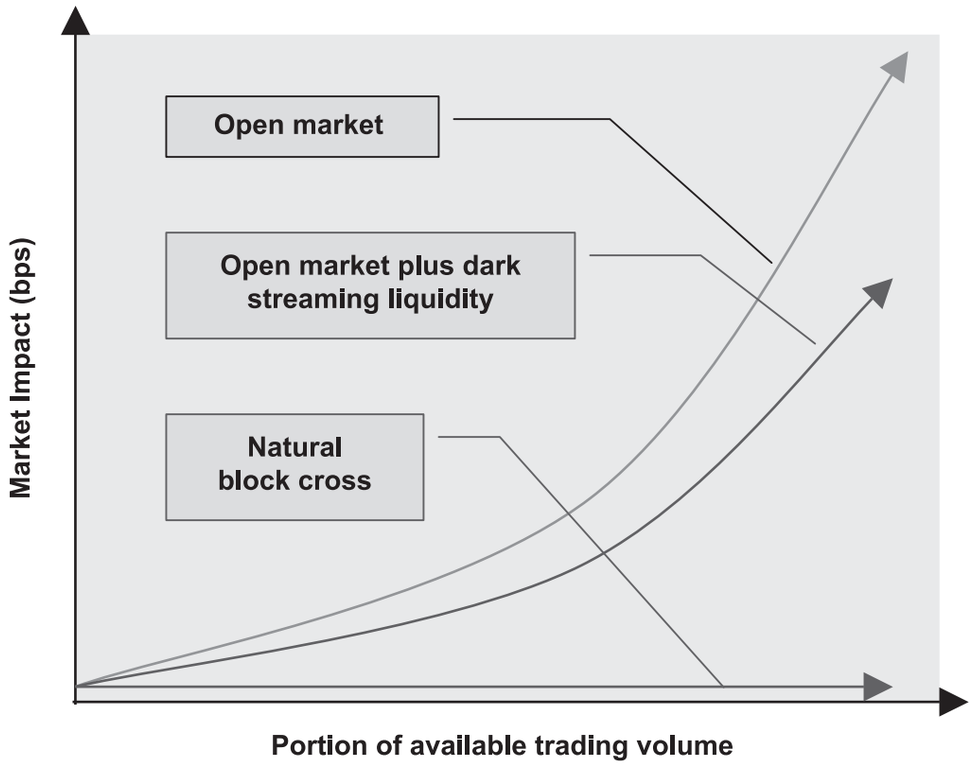
Traders need to have a very clear understanding of the kinds of dark liquidity with which they are interacting. Contra-parties, and their liquidity, range from hugely desirable to genuinely toxic. Interacting with great liquidity affords near-zero market impact for a trader. In contrast, toxic contras not only provide no useful liquidity; they exploit the information value in every trade.

Exhibit 4 shows a spectrum of liquidity quality ranging from best at the top to worst at the bottom. Simply stated, good liquidity is not price informed. Therefore, at the very top of the liquidity-quality spectrum is retail flow. Retail traders tend to be the opposite of price informed—directionally they sell at the bottom and buy at the top. No information leaks in these trades because retail contra-parties are in no position to detect a pattern.

Stepping down only slightly in the spectrum, the next highest-quality liquidity stems from the current orders of large investors who have fundamental long-term reasons to buy or sell a stock. The longer the investor's time horizon, the higher the quality of liquidities. Exhibit 4 depicts gradations in the Natural Block Liquidity. If a trader can find a way to interact with this top-quality liquidity, he can get his trade done with little or no market impact. The huge advantage of natural block liquidity over retail liquidity is its size. It is hard to put together more than 5% of ADV in retail flow with which to trade, whereas institutions routinely find themselves with 500% of ADV they need to trade.

Lower on the spectrum is black-box trading, which includes algorithmic trading and automated market-making. Finally, at the bottom, we see pure proprietary intra-day

EXHIBIT 3



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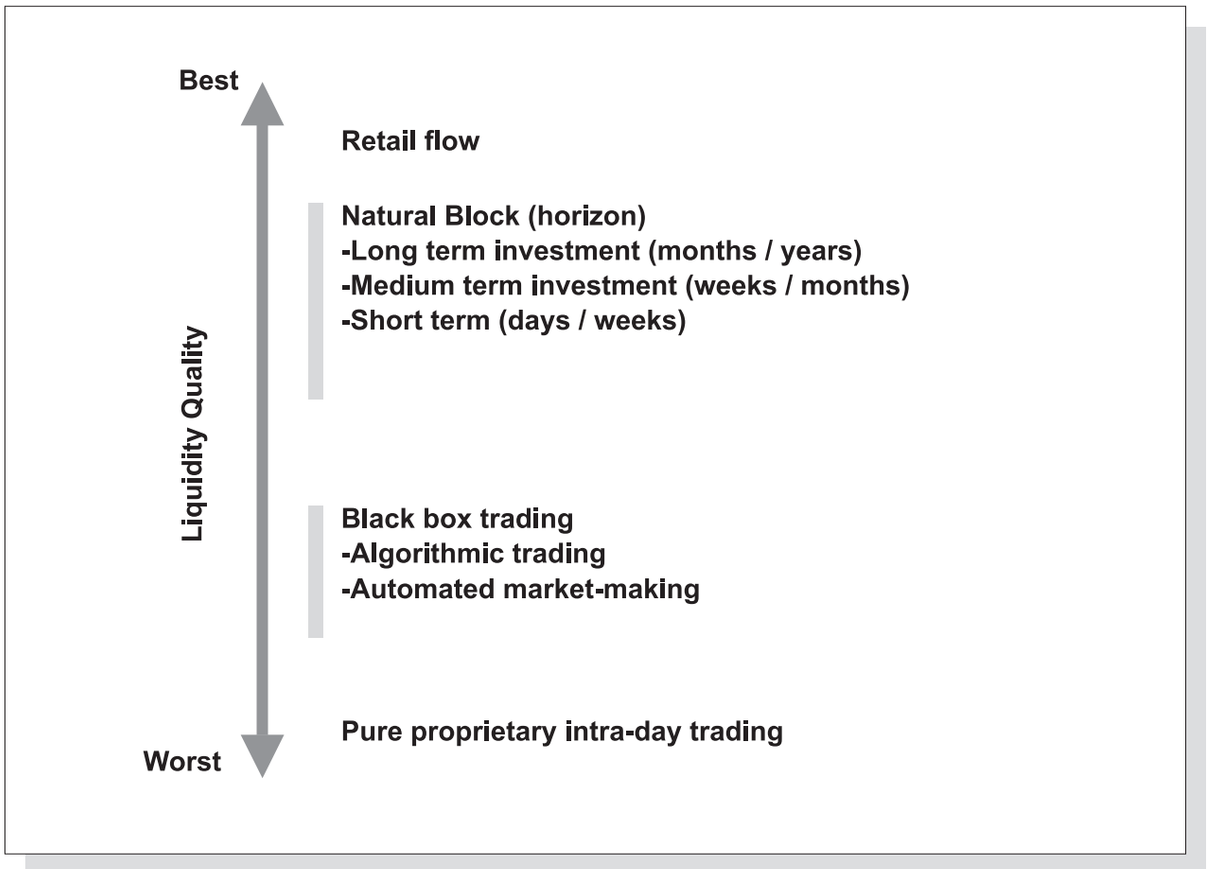
trading. Unlike investors who have long time horizons and simply want to buy or sell the stocks, black box engines and intra-day proprietary traders have very short-term time horizons—often measured in minutes or seconds—and base their decisions to move quickly in and out of securities on how prices move in relation to their parameters. From the portfolio manager's and trader's perspective, these are sources of low-quality liquidity that can be viewed as competition for buying or selling a stock at the best price. And, information leakage has to be a huge concern.

HOW CAN TRADERS BEST ACCESS DARK LIQUIDITY?

The trader needs to understand the merits of the various venues for accessing dark liquidity. In Exhibit 5, we see five categorical alternatives. As illustrated by the vertical arrows on the left side of the graph, working from left to right, these five methods represent progressively higher liquidity quality, larger order sizes, more automation, and less time and labor required of the trader. The method shown at the top is direct market access (DMA) to various dark liquidity pools such as Millennium. Here the trader searches all the individual dark pools for available liquidity and places small orders here and there. Sometimes he may probe the market by placing a "child order" that represents just a small portion of the total amount he wants to trade. The trader might also send an order to the NYSE via Millennium and benefit from an immediate fill if Millennium just so happens to have a reciprocal resting order. The advantage of the DMA method is that it provides the trader with a good feel of the market, but this method is generally very labor intensive and time consuming in relation to the liquidity the trader is able to find during the course of the day. Under the worst circumstances, he could find himself with few or no trades placed after many hours of hard work.

The next method down on the list is the dark pool DMA aggregator, which continually probes a series of dark pools and saves the trader from having to do it man-

EXHIBIT 4



ually. This method can be effective for orders up to about 10,000 shares. And next down on the graph is the dark probe algorithm, which is generally capable of handling orders in the 100,000-share range. Algorithms are designed to try to replicate what the trader would have done, playing all the known dark liquidity pools at the same time. How well this method works depends partly on the skill of the financial engineers who design the algorithms.

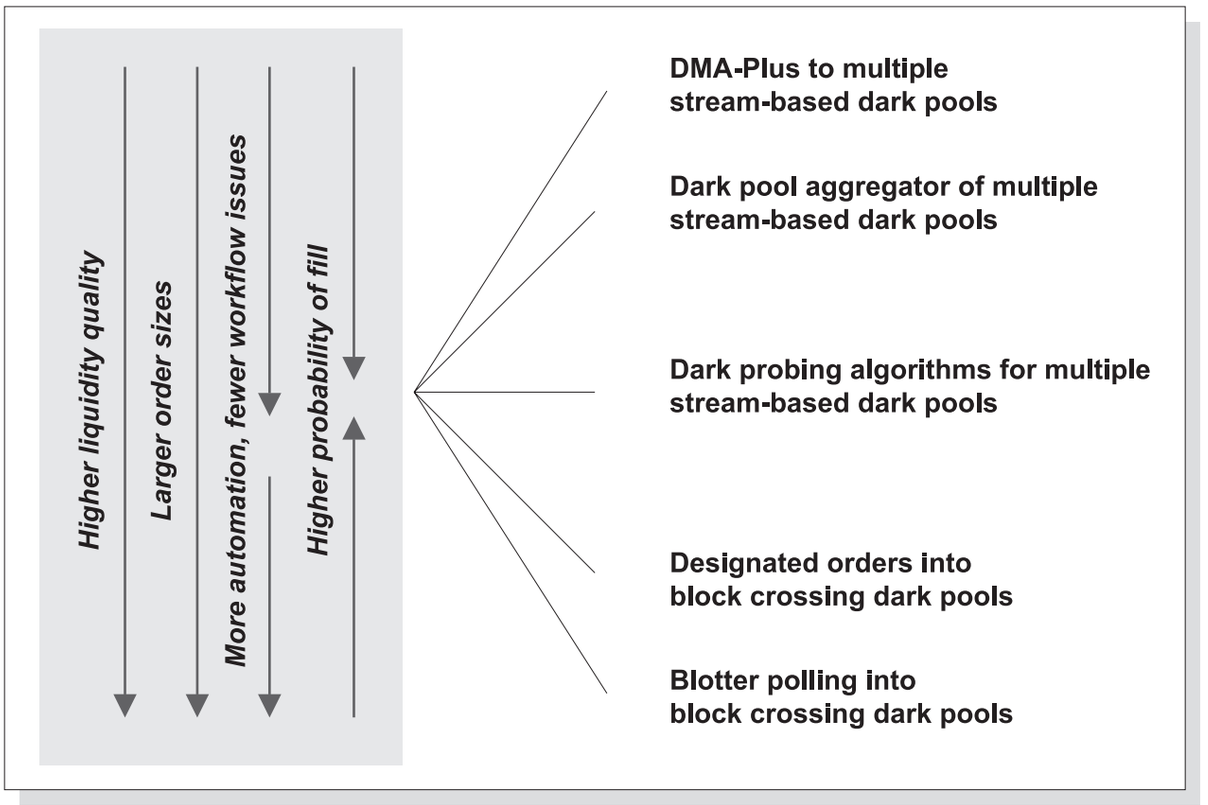
Then the two methods at the bottom of the list are designed for large-block transactions. With designated block order systems, such as Pipeline and POSIT, the trader can place a resting order to find a natural cross for a given amount, say 100,000 shares, but not to trade at all if such a cross is not found. Here the trader is saying he wants the highest quality liquidity or none at all. The downside of this method is that even with systems offered by the largest financial institutions, the cross rate tends to be less than 10%. Furthermore, while the trader has an order placed with a designated block order system, he cannot shop around for other ways to execute the order. Therefore, 90% of the time the trader receives the order back unfilled at the end of the day.

The final method, at the bottom of the vertical axis, is called blotter polling. A blotter polling system reads the entire inventory of trades waiting to be executed on the trader's blotter, or order management system (OMS), and polls the blotters of hundreds of other traders. While continuing to work the markets, and letting the trader know when and if it comes up with a cross, a blotter polling system does not restrict the trader from continuing to work the markets on his own.

CONCLUSION

Traders today are actively looking for ways to meet the challenges of an increasingly complex industry where accessing and managing multiple sources of global liquidity, rather than pure, immediate execution alone, determines

EXHIBIT 5



the best overall results. Innovative, relevant solutions to these challenges focus on giving traders maximum choice over where and how to trade, more control over the outcome of their trades, broad connectivity to global markets and global points of liquidity, and optimal cost efficiency in their trading transactions. Advanced, sophisticated liquidity management technologies offer the tools traders need to leverage the interconnectivity of today's growing multi-asset markets and work as effectively, creatively, and intelligently as possible within the dynamics of this new environment.