INVESTMENT COMPANY INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

October 3, 2011

Steven Maijoor
Chair
European Securities and Markets Authority
103 Rue de Grenelle, 75007 Paris
FRANCE

Re: *Consultation on Guidelines on Systems and Controls in a Highly Automated Trading Environment for Trading Platforms, Investment Firms and Competent Authorities*

Dear Chairman Maijoor:

The Investment Company Institute ("ICI") strongly supports the European Securities and Markets Authority's ("ESMA") issuance of a consultation seeking comment on draft guidelines on systems and controls for the current automated trading environment.[1] The Consultation raises a number of issues of importance to ICI members.

ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds ("ETFs"), and unit investment trusts ("UITs").[2] The structure of the global financial markets has a significant impact on ICI members, who are investors of approximately $12.5 trillion of assets. We are institutional investors, but invest on behalf of over 90 million individual shareholders.[3] According to ICI data, as of March 2011, U.S. based long-term mutual funds held $2.4 trillion in non-U.S. securities, accounting for almost 25 percent of the assets of these funds. U.S. registered investment companies and their shareholders therefore have a strong interest in ensuring that the global financial markets are highly competitive, transparent and efficient, and that the regulatory

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[1] *Guidelines on Systems and Controls in a Highly Automated Trading Environment for Trading Platforms, Investment Firms and Competent Authorities*, European Securities and Markets Authority (July 2011) ("Consultation").

[2] ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers.

[3] For more information on the U.S. registered investment company industry, *see* 2011 Investment Company Institute Fact Book at www.icifactbook.org.

structure that governs the financial markets encourages, rather than impedes, liquidity, transparency, and price discovery.[4]

ICI has strongly supported the examination of issues related to automated trading as well as other issues that may impact the fair and orderly operation of the global financial markets and investor confidence in those markets. We have long advocated for appropriate regulatory changes to address investor concerns; our comments on the Consultation reiterate many of the comments made in prior ICI letters on other proposals and consultations related to automated trading including several focusing on the reform of the structure of the European financial markets.[5] ICI offers its assistance to ESMA as it continues to examine the issues raised by the Consultation and their impact on the financial markets.[6]

Our comments and recommendations on the issues raised in the Consultation follow below.[7]

## I. SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Draft guidelines on systems and controls in a highly automated trading environment for trading platforms and investment firms

- We believe it is appropriate to introduce guidelines at this time, before the review of MiFID is complete, given the significance of issues raised by automated trading and regulatory developments in this area.

[4] The issues discussed in the Consultation impact all U.S. registered investment companies, including mutual funds, closed-end funds, and ETFs. For purposes of this letter, we refer to U.S. registered investment companies as "funds."

[5] For a comprehensive list of, and links to, ICI's key comment letters and statements on trading and market structure issues, *see* Appendix A.

[6] While addressing many issues related to the current automated trading environment, the Consultation does not propose guidelines on several issues that have become associated with automated trading including, among other things, co-location, fee structures and tick sizes. The Consultation states that these issues do not relate directly to the challenges for systems and controls of trading platforms and investment firms caused by a highly automated trading environment and that there is a limit to what ESMA could achieve through guidelines in these areas under the existing legislative framework. The Consultation adds, however, that this is without prejudice to ESMA's ability to undertake future work in these areas. ICI has provided comments on these issues in our past comment letters and believes they are important topics to examine in the context of an automated trading environment. We therefore urge ESMA to further examine these issues when appropriate. For a list of ICI comment letters discussing our views on co-location, fee structures, and tick sizes, *see* Appendix A.

[7] Our comments and recommendations are focused on the impact of technological changes on the equity markets. ICI members, however, also are active participants in the derivatives and fixed-income markets and changes to the structure of those markets will have an impact on the manner in which funds execute trades and interact with other market participants. ICI therefore strongly supports a robust examination of the current market structure and the impact of technological changes in the non-equity markets.

- We believe automated trading has impacted the manner in which funds trade; funds must now take into account: the impact of the increase in volume of trading attributed to high frequency traders and the significant amount of automated trading in general; fragmentation in the markets and the number and types of alternative trading venues available; and new tools available to funds when trading.

**Guidelines 1 and 2: Organizational requirements for electronic trading systems of trading platforms and investment firms**

- We strongly support establishing guidelines that address key issues such as governance, testing, staff, recordkeeping, and cooperation with regulators and believe a robust compliance and risk management program is critical given the prominence of automated trading.

- We support subjecting algorithms to appropriate rules and controls, such as requirements for policies and procedures aimed at preventing algorithms from operating in an unintended manner; at the same time, regulators must be careful not to impede funds' use of new and innovative trading tools.

- We believe it is critical that trading platforms and investment firms inform regulators about significant incidents that may affect the operations of automated trading systems and algorithms and cooperate with regulators to address risks.

**Guidelines 3 and 4: Organizational requirements for trading platforms and investment firms to promote fair and orderly trading in a highly automated trading environment**

- We support the implementation by trading platforms of proper risk controls and arrangements to mitigate the risk of errors generated by automated trading including arrangements to intervene in trading or to halt trading in individual or multiple financial instruments when necessary, on both an automatic and discretionary basis, to maintain an orderly market.

- We support guidelines for investment firms that cover erroneous order entry, risk management, and operational risk such as arrangements designed to prevent fraud by employees.

- We believe that disclosure of information to investors cannot be discounted when considering requirements to promote fair and orderly trading and recommend that regulators examine the sufficiency of information provided by trading venues to investors about trade execution, including whether investors are receiving adequate and accurate information about how orders are handled and routed.

**Guidelines 5 and 6: Organizational requirements for trading platforms and investment firms to prevent market manipulation in a highly automated trading environment**

- We believe guidelines intended to prevent market manipulation are critical for efficient markets and investor confidence.

- We believe some trading practices utilized by automated trading firms may pose problems for long-term investors; we support action by regulators to clearly define practices that may constitute market manipulation to ensure adequate regulatory consequences for these practices.

- We strongly support an examination by regulators whether any new regulations are necessary to address certain trading strategies that should be considered as improper or manipulative and urge regulators to address issues relating to abusive or disruptive trading on an expedited basis.

- We strongly support regulators having access to accurate, timely and detailed information about market participants and trades that are executed; we therefore support a more robust transaction reporting regime to enable regulators to monitor the activities of firms, ensure compliance with MiFID, and monitor for market abuses.

**Guidelines 7 and 8: Organizational requirements for direct market access and sponsored access**

- We believe the establishment of robust pre- and post-trade risk controls is critical given the prevalence of high frequency trading and algorithmic trading, significantly the implementation of controls designed to manage the risks associated with market access.

- We support requiring investment firms that provide sponsored access to have in place robust risk controls and filters to detect errors or attempts to misuse facilities but recommend that the scope of any regulations in this area not impair the confidentiality of fund trading information.

## II. General Comments

As the Consultation notes, trading has evolved significantly in just the past few years and has come to rely increasingly on the use of automated trading systems; an important part of these changes has been the rise of the use of algorithms and high frequency trading ("HFT").

We are therefore pleased that ESMA has determined to take a comprehensive look at systems and controls necessary for the current automated trading environment. The issues surrounding the trading of financial instruments by funds and other institutional investors, including those raised by technological changes in the markets, are clearly no longer purely a domestic matter. Many U.S. funds execute trading strategies through intricately linked global trading desks and must be concerned about the regulation and structure of financial markets in all jurisdictions in which they trade, not just the

United States. In particular, many of our members are very active in the European markets and are therefore particularly interested in the ESMA review.

In addition, as the Consultation recognizes, jurisdictions around the world are starting to, or are already facing, a number of common issues and it is desirable to achieve a broad consistency of approach to these issues across different jurisdictions given the links between the financial markets in Europe and the rest of the world. As ESMA considers initiatives relating to the reform of the regulation of the European financial markets, we urge it to work closely with regulators around the globe to create consistent and sensible cross-border regulations. Our increasingly global markets demand such cooperation among regulators to avoid negative consequences of incongruent regulatory requirements and to encourage regulatory efficiencies as funds pursue an increasing cross-border presence in the interest of their shareholders.

We recognize that the draft guidelines are only one part of ESMA's work on issues related to automated trading and HFT. To that end, ICI believes it is important that the specific market structure issues raised by the Consultation not be viewed in a vacuum and that ESMA take into account efforts by other jurisdictions to study and implement market structure reform to ensure that any rulemaking initiatives arising from ESMA's review be harmonized globally.

ICI also urges ESMA to take a measured approach in any responses they feel appropriate and necessary to address the impact of automated trading on market efficiency and integrity. If regulations are too restrictive, they may unintentionally limit the use of evolving market practices and technological developments and thus impede funds' use of new and innovative trading tools and trading venues. In addition, if regulations are too onerous or costly for some market participants, those participants may decide not to offer certain products or services to investors. Similarly, the cost of trading may increase as market participants shift the burden of compliance with new requirements to investors. We therefore urge ESMA to carefully balance these potential costs with the benefits any new regulations would provide to investors.

## A. Impact of Automated Trading and High Frequency Trading on Funds

As discussed above, trading has evolved significantly in just the past few years and has come to rely increasingly on the use of automated trading systems. As the Consultation notes, these systems have permeated almost all aspects of trading: open outcry markets have largely been replaced with screen-based markets; screen-based markets are usually accessed electronically by members/participants and users; order flow from clients is often captured and routed electronically to trading platforms by investment firms; and investment firms and their clients have made increasing use of trading algorithms whereby orders are generated by computer algorithms responding to market data.

ICI has spent a significant amount of time examining the impact of automated trading, particularly HFT, on the financial markets and on investors. These practices have forced funds and other institutional investors to modify their own trading strategies. When determining the most efficient approach to executing a trade, funds must now take into account: (1) the impact of the increase in volume of trading attributed to certain market participants such as high frequency traders and the significant amount of automated trading in general; (2) fragmentation in the markets and the number and types of alternative trading venues available; and (3) the new technology and tools available to funds when trading.

Funds also have become more diligent in choosing their counterparties and the venues to which they route their orders to protect the confidentiality of information regarding their trades. As we have stated in several letters to the U.S. Securities and Exchange Commission ("SEC"),[8] any premature or improper disclosure of this information can lead to frontrunning of a fund's trades, adversely impacting the price of the stock that the fund is buying or selling.

The Consultation notes several benefits of a highly automated trading environment, including enabling investors to monitor prices in real time and submit orders electronically, facilitating productivity improvements at investment firms executing client orders and at trading platforms, promoting competition between trading platforms, and simplifying the process of the settlement of trades. Nevertheless, the Consultation recognizes that several concerns also have been expressed about trading in a highly automated environment including facilitating trading activities such as HFT, adversely affecting the quality of markets through the decrease of trade size and by pushing up indirect trading costs for retail and institutional investors, and the potential for disorderly trading conditions.

ICI agrees with the Consultation's assessment of the benefits and concerns of a highly automated trading environment. For example, HFT arguably brings several benefits to the markets and to investors, including providing liquidity and tightening spreads. At the same time, ICI members have expressed concerns about several practices that have become associated with high frequency trading. These include, among other things, the creation of unnecessary market traffic and misleading market "noise," particularly due to the submission of numerous orders that are cancelled shortly after submission, and the use of certain practices to detect the trading of large blocks of securities by funds and to trade with or ahead of those blocks.

As we discuss the topics raised by the Consultation, it is important to note that ICI believes that investors, both retail and institutional, are better off than they were just a few years ago and that overall, the markets are operating efficiently. Most significantly, trading costs have been reduced, more trading tools are available to investors with which to execute trades, and technology arguably has increased the overall efficiency of trading. Nevertheless, as discussed in further detail below, funds

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[8] *See, e.g.*, Letters from Paul Schott Stevens, President, Investment Company Institute, to Christopher Cox, Chairman, Securities and Exchange Commission, dated September 14, 2005 (available at http://www.ici.org/pdf/comment_leakage_05.pdf); August 29, 2006 (available at http://www.ici.org/pdf/comment_leakage_06.pdf); and September 19, 2008 (available at http://www.ici.org/pdf/comment_leakage_08.pdf).

remain concerned about the challenges created by recent technological developments, including automated trading.

## III. Draft guidelines on systems and controls in a highly automated trading environment for trading platforms and investment firms

In general, the draft guidelines cover three areas, with separate standards relating to trading platforms and investment firms in each area: electronic trading systems, fair and orderly trading and market abuse (in particular, market manipulation). Draft guidelines also are proposed for the provision of direct market access or sponsored access by an investment firm.

The Consultation requests comment whether it is appropriate to introduce guidelines before the review of MiFID is complete. As the Consultation notes, the draft guidelines fall under the existing legal framework provided by MiFID and the Markets Abuse Directive ("MAD") which are currently under review. We agree with ESMA that given the importance of the issues raised by automated trading, regulatory developments around the globe, and the fact that regulators are already seeking to deal with issues related to automated trading within the existing legal framework, it is appropriate to introduce guidelines at this time.

In addition, ICI believes the regulatory objectives expressed in the Consultation for authorities in overseeing trading platforms and investment firms in relation to secondary markets trading are critical, in particular: (1) protecting investors by ensuring that those acting as agent for investors act in the best interests of their clients; (2) ensuring fair and orderly trading so that one set of investors does not gain an unfair advantage and that there is an efficient process of price formation; (3) promoting market integrity by seeking to prevent, detect and punish improper behavior which undermines the integrity of the market; and (4) strengthening financial stability by ensuring that secondary market trading does not give rise to behavior that risks a disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy.

Introducing guidelines at this time should facilitate the achievement of these objectives. For example, as the Consultation notes, implementation of the guidelines should ensure that investors are more consistently protected against investment firms making errors when entering their orders, resulting in greater confidence and less uncertainty in trading. In addition, if the risk of market manipulation is reduced, this should help to give investors greater confidence and potentially aid liquidity and price discovery, thereby lowering costs for investors and issuers of capital.[9]

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[9] The Consultation recognizes, however, that once MiFID and MAD have been revised, it will be necessary for ESMA to revisit the guidelines, if adopted, to consider whether they need to be adapted in the light of the new legislative framework or transformed into technical standards covering some or all of the issues in the Consultation. We look forward to working with ESMA as it considers the guidelines and any revisions once MiFID is formally adopted. ICI recommends that such review occur promptly after MiFID is finalized.

## A. <u>Guidelines 1 and 2: Organizational requirements for electronic trading systems of trading platforms and investment firms</u>

The Consultation sets forth a set of draft guidelines aimed at risk management, sound management of technical operations, and effective contingency arrangements relating to electronic trading systems, including algorithms. ICI strongly supports establishing guidelines for trading platforms and investment firms in this area that address key issues such as governance, testing, staff, recordkeeping, and cooperation with regulators. We believe a robust compliance and risk management program is critical given the prominence of automated trading.

Similarly, we believe the increased use of algorithms has raised several valid regulatory concerns. These include algorithms that may act in an unexpected or unintended manner leading to sudden liquidity imbalances that quickly drive prices up or down. We therefore support draft guidelines related to the use of clearly delineated development and testing methodologies to seek to ensure that, among other things, the operation of electronic trading systems or trading algorithms is compatible with an investment firm's obligations under MiFID and other relevant regulations as well as the rules of the trading platforms they use, that the compliance and risk management controls embedded in the system or algorithm work as intended, and that the electronic trading system or algorithm can continue to work effectively in stressed market conditions. We believe draft guidelines such as these will go far in addressing concerns related to the operation of automated trading systems and algorithms.

Finally, we believe it is critical that trading platforms and investment firms inform regulators about significant incidents that may affect the sound management of the technical operations of automated trading systems and algorithms and cooperate with regulators to address risks. Given the potential impact on the financial markets as a whole of a significant incident related to an automated trading system, it is crucial that regulators have access to accurate and timely information and are aware of any significant risks to the sound operation of trading platforms' electronic trading systems and investment firms' algorithms that arise to ensure a robust regulatory scheme.

## B. <u>Guidelines 3 and 4: Organizational requirements for trading platforms and investment firms to promote fair and orderly trading in a highly automated trading environment</u>

The Consultation sets out guidelines for controls to promote fair and orderly trading. ICI supports trading platforms having arrangements in place to intervene in trading or to halt trading in individual or multiple financial instruments when necessary, on both an automatic and discretionary basis, to maintain an orderly market. For example, the Consultation notes that trading platforms need to have automatic mechanisms, *i.e.*, circuit breakers, in place to constrain trading or halt trading in a specific financial instrument or more widely in response to significant variations in price to prevent trading becoming disorderly.[10] We similarly support guidelines for investment firms that cover

[10] The Consultation notes that each trading platform is responsible for its own circuit breakers and that under the existing MiFID framework, regulators do not have the ability to require the coordination between different trading platforms

erroneous order entry, risk management, and operational risk such as arrangements designed to prevent fraud by employees.[11]

The "flash crash" of May 6, 2010 in the United States highlighted the need to implement circuit breakers or so-called "limit up-limit down" systems to mitigate instances of sudden market volatility or the risk of errors generated by automated trading. ICI strongly supported efforts to initially address market volatility through the establishment of single-stock circuit breakers. While the single-stock circuit breaker pilot program in the United States was a significant step in addressing concerns about volatility, ICI has supported the further action by regulators to establish a limit up-limit down system that would replace the single-stock circuit breaker pilot and provide a more flexible approach to addressing extreme price movements in stocks. We believe similar trading control mechanisms can be useful in other jurisdictions.

On May 6, 2010, many trades were cancelled according to the securities markets' "clearly erroneous rules," which provide the securities exchanges with the ability to cancel trades effected at prices that were sharply divergent from prevailing market prices. The SEC has since approved rules to reform the process of breaking "clearly erroneous" trades. The previous arbitrary process by which the threshold level for correcting trades was set did not work effectively and did not operate in the best interests of investors. We support the implementation of similar rules by other jurisdictions.

Finally, the flash crash in the United States made clear the need to address the inconsistent practices employed by individual exchanges to supplement existing circuit breakers. On May 6, 2010, the differing trading protocols at the exchanges contributed to the severe excess of sell orders over buy orders and the resulting decline in stock prices. We strongly encourage trading platforms to work together to eliminate inconsistencies in trading protocols and to harmonize, to the extent possible, policies and procedures in this area. Consistency and reliability in the application of trading pauses is critical for investors.

The Consultation notes that the concept of fair and orderly trading has a wide application, covering many aspects of the operation of markets including, for example, the information made available to investors about the trading in a financial instrument, including trading interest and completed transactions. The Consultation states, however, that it focuses only on the aspect of fair and

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trading the same financial instrument regarding how automatic circuit breakers will work. As discussed below, and based on experience in the United States with uncoordinated trading platforms, we believe the coordination between different trading venues is critical and we encourage trading platforms to work together to eliminate inconsistencies in trading protocols and to harmonize policies and procedures in this area.

[11] The Consultation notes that investment firms' controls will be partly duplicative of those of trading platforms but that this will help to reinforce the protections for fair and orderly trading and allows the investment firm to set its controls more tightly than those of the trading platform in the light of its own risk appetite. The Consultation adds, however, that the controls of investment firms also need to be more extensive to deal with the risks they are exposed to in executing orders on behalf of clients and dealing on their own account.

orderly trading that relates to the controls that trading platforms impose on their members/participants and users. While we understand the desire of ESMA to focus on the particular aspects of fair and orderly trading in the Consultation, we believe that disclosure of information to investors cannot be discounted. For example, ICI has set forth a number of recommendations that would increase pre- and post-trade transparency of market information as well as transparency regarding how orders are executed and routed.[12] We recommend that ESMA examine the need for increased transparency in these areas.

## C. Guidelines 5 and 6: Organizational requirements for trading platforms and investment firms to prevent market manipulation in a highly automated trading environment

ICI believes that the most important set of draft guidelines for efficient markets and investor confidence may be those set forth in the Consultation intended to prevent market manipulation. Specifically, the draft guidelines state that trading platforms should have effective arrangements and procedures which enable them to identify conduct by their members/participants and users that may involve market manipulation in a highly automated trading environment. Similarly, investment firms should have policies and procedures in place to minimize the risk that their highly automated trading activity gives rise to market manipulation.

ICI has spent a significant amount of time examining the potential for automated trading to contribute to market manipulation. In particular, as discussed above, our members report that some of the practices utilized by automated trading firms, such as HFT firms, may pose problems for long-term investors.[13] Many of these practices are similar to those noted in the Consultation. Specifically, the Consultation notes that, in the context of challenges posed by trading in a highly automated environment, ESMA's focus is on possible instances of market abuse related to orders which give false or misleading signals as to the supply of, or demand for, or price of, financial instruments. The Consultation provides a number of examples of such practices including ping orders, quote stuffing, momentum ignition strategies, and layering and spoofing.

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[12] We believe improved information in these areas would allow investors to make better informed investment decisions and, in turn, facilitate best execution, as well as assist regulators and other market participants in assessing current market performance.

[13] For example, an automated trading firm may seek to ascertain the existence of one or more large buyers (sellers) in the market and to buy (sell) ahead of the large orders with the goal of capturing a price movement in the direction of the large trading interest. After a profitable price movement, the firm then may attempt to sell to (buy from) the large buyer (seller) or be the counterparty to the large buyer's (seller's) trading. In addition, the automated trading firm may view the trading interest of the large buyer (seller) as a free option to trade against if the price moves contrary to the firm's position. Similarly, an automated trading firm may utilize a strategy where it may initiate a series of orders and trades in an attempt to ignite a rapid price move either up or down. For example, the trader may intend that the rapid submission and cancellation of many orders, along with the execution of some trades, will "spoof," or fool, the algorithms of other traders into action and cause them to buy (sell) more aggressively.

ICI believes technology has made the use of these strategies much easier and cheaper to employ, thereby lowering the risk to users of these strategies. This, in turn, has made trading more difficult for funds that are interested in buying and selling large positions and that are hurt by market participants that trade in front of their orders. ICI has therefore strongly supported examinations by regulators whether any new regulations are necessary to address certain trading strategies that should be considered as improper or manipulative and have urged regulators to address issues relating to abusive or disruptive trading on an expedited basis. The draft guidelines should facilitate the effective monitoring of these strategies.

ICI also strongly supports policies and procedures to control leakage of information regarding a customer's order and other confidential information. As discussed above, the confidentiality of information regarding orders is arguably the most significant consideration for funds when trading. Similarly, we support action by regulators to clearly define practices involving algorithmic trading strategies that may constitute market manipulation, in order to ensure adequate regulatory consequences for these practices. The varied and complex trading practices used by market participants often makes it difficult to distinguish between legitimate and disruptive trading practices in a number of situations. Lack of clarity also may have a chilling effect on legitimate practices or make enforcement of illegal activities more difficult.

We are pleased the Consultation recognizes the challenges for regulators, as well as trading venues and investment firms, in spotting potentially abusive behavior. It is clear that regulations governing the financial markets have not kept pace with the significant changes in market participants' trading practices. This includes regulations on market abuse and disorderly trading related to computer generated orders. ICI believes the fragmentation of the financial markets and the submission of large numbers of orders and trades across multiple venues also create difficulties for regulators' surveillance capabilities.

ICI therefore strongly supports regulators having adequate arrangements in place to examine the changes to the structure of the financial markets and to identify emerging issues in a timely fashion. Most significantly, ICI believes that regulators should have access to accurate, timely and detailed information about market participants and the trades that are executed. To this end, we believe that a robust transaction reporting regime is necessary to enable regulators to monitor the activities of firms and ensure compliance with regulations and to monitor for market abuses. In the United States, ICI has supported efforts to create a reporting regime for regulators with respect to the SEC's proposal to develop, implement, and maintain a consolidated audit trail ("CAT"). The SEC also recently adopted a large trader reporting system that would enhance the ability to identify the effects of certain large trader activity on the markets, reconstruct trading activity following periods of unusual market activity, and analyze market events and trading activity for regulatory purposes. ICI strongly supports an examination by ESMA and other regulators of similar transaction reporting regimes.

**D. <u>Guidelines 7 and 8: Organizational requirements for direct market access and sponsored access</u>**

The Consultation contains several guidelines for organizational requirements for direct market access and sponsored access. Much of the focus in the United States around pre- and post-trade risk controls has been on the establishment of requirements relating to sponsored access and other types of market access arrangements. As the Consultation notes, risks related to automated trading can arise when an automated trader uses the facilities of another firm to access the market. For example, when firms allow their trading IDs to be used by other firms, it can pose potential risks not only to the intermediary firm, but to other firms throughout the trading chain.

ICI strongly supported the adoption by the SEC of rules to require broker-dealers to implement risk management controls and supervisory procedures reasonably designed to manage the risks associated with market access. Similarly, we supported efforts by IOSCO in its consultation report on direct electronic access to provide a framework for crafting regulations on these arrangements. At the same time, we have urged regulators to ensure that the scope of any regulations in this area does not unnecessarily affect the various methods that funds use to trade securities through broker-dealers or lead to unintended consequences for funds and other institutional investors using market access arrangements, particularly regarding the confidentiality of trading information.[14] We believe our recommendations in this area are applicable to trading platforms and investment firms that will be examining risk management controls under ESMA's draft guidelines.

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If you have any questions on our letter, please feel free to contact me directly at (202) 326-5815, or Ari Burstein at (202) 371-5408.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan
General Counsel

[14] To address these concerns in the United States, ICI recommended that, at the very least: (1) unless expressly authorized to the contrary by a customer, access to information regarding a market access customer's orders and trades be limited to broker-dealer compliance personnel directly associated with overseeing market access controls and procedures; (2) that information required to be disclosed must be relevant to specific risk concerns created by market access; and (3) that the SEC make clear that broker-dealers who obtain information also have adequate confidentiality safeguards and controls in place to protect such information and that the information be used exclusively for regulatory purposes.

# APPENDIX A

## KEY ICI COMMENT LETTERS AND STATEMENTS ON MARKET STRUCTURE ISSUES

Order Execution Obligations: Letter from Craig S. Tyle, Senior Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated January 16, 1996; available at http://www.ici.org/pdf/7561.pdf

Regulation of Exchanges and Alternative Trading Systems: Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated July 28, 1998; available at http://www.ici.org/pdf/comment98_reg_exch_ats.pdf

Market Fragmentation Concept Release: Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated May 12, 2000; available at http://www.ici.org/pdf/11894.pdf

Subpenny Concept Release: Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated November 20, 2001; available at http://www.ici.org/policy/comments/01_SEC_SUBPENNY_COM

Regulation NMS: Letter from Ari Burstein, Associate Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated June 30, 2004; available at http://www.ici.org/policy/markets/domestic/04_sec_nms_com

Disclosure of Short Sales and Short Positions: Letter from Ari Burstein, Senior Counsel, Investment Company Institute, to Florence Harmon, Acting Secretary, Securities and Exchange Commission, dated December 16, 2008; available at http://www.ici.org/pdf/23128.pdf

IOSCO Consultation on Regulation of Short Selling: Letter from Ari Burstein, Senior Counsel, Investment Company Institute, to Greg Tanzer, Secretary General, IOSCO, dated May 18, 2009; available at http://www.ici.org/pdf/comment_051809_iosco_consult.pdf

IOSCO Consultation on Direct Electronic Access: Letter from Ari Burstein, Senior Counsel, Investment Company Institute, to Greg Tanzer, Secretary General, IOSCO, dated May 20, 2009; available at http://www.ici.org/pdf/23474.pdf

Amendments to Regulation SHO (Short Selling): Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 19, 2009; available at http://www.ici.org/policy/comments/cov_comment/09_sec_short_sale_com

U.S. Senate Market Structure Hearing: Statement of the Investment Company Institute, Hearing on "Dark Pools, Flash Orders, High Frequency Trading, and Other Market Structure Issues," Securities, Insurance, and Investment Subcommittee, Committee on Banking, Housing & Urban Affairs, U.S. Senate, October 28, 2009; available at http://www.ici.org/pdf/23925.pdf

Flash Orders: Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated November 23, 2009; available at http://www.ici.org/pdf/23973.pdf

Non-Public Trading Interest: Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated February 22, 2010; available at http://www.ici.org/pdf/24142.pdf

Market Access: Letter from Ari Burstein, Senior Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated March 29, 2010; available at http://www.ici.org/pdf/24210.pdf

SEC Concept Release on Equity Market Structure: Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated April 21, 2010; available at http://www.ici.org/pdf/24266.pdf

SEC Market Structure Roundtables: Letters from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 1, 2010 and June 23, 2010; available at http://www.ici.org/pdf/24361.pdf and http://www.ici.org/pdf/24384.pdf

Circuit Breakers: Letters from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 3, 2010 and July 19, 2010; available at http://www.ici.org/pdf/24364.pdf and http://www.ici.org/pdf/24438.pdf

Large Trader Reporting System: Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 22, 2010; available at http://www.ici.org/pdf/24381.pdf

Clearly Erroneous Executions: Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated July 19, 2010; available at http://www.ici.org/pdf/24437.pdf

Consolidated Audit Trail: Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated August 9, 2010; available at http://www.ici.org/pdf/24477.pdf

European Commission Review of MiFID: Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Directorate General, European Commission, dated February 2, 2011; available at http://www.ici.org/pdf/24946.pdf

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