Comment Letter on NYSE Proposal Relating to New Trading Service, July 2000

July 6, 2000

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: NYSE Direct+
(File No. SR-NYSE-00-18)

Dear Mr. Katz:

Set forth below are the comments of the Investment Company Institute[1] on the proposed rule change[2] ("Proposal") filed by the New York Stock Exchange relating to NYSE Direct+, a proposed new facility of the Exchange which would provide automatic execution for certain limit orders of 1,099 shares or less ("auto ex" orders).

In general, the Institute supports modifications to the Exchange's trading systems. Our members, who are investors of approximately $7 trillion of assets for over 78 million individual shareholders, have a strong interest in ensuring that trading in the listed market is made more efficient. More specifically, steps to promote the automatic execution of orders and to reduce the need for dealer intervention is crucial to an effective market structure going forward. The Institute therefore supports the intent of the Proposal. Nevertheless, the Institute believes that there are certain aspects of the Proposal that require further examination before the SEC approves the Proposal.

Following are some of the shortcomings of the Proposal. Given the Proposal's de minimis comment period, however, we are not able to offer more comprehensive comments at this time. As the Institute has noted in the past,[3] a 21-day comment period is woefully inadequate to provide meaningful input on important SRO proposed rule changes. Given the amount of resources the SEC has devoted to efforts to restructure the U.S. securities markets, it would seem fundamental that the SEC would provide "interested persons" with an "opportunity to submit ... views and arguments" concerning the proposed rule change.[4] We question whether providing the public with 21 days to comment on a proposal to restructure the NYSE market, with several of those days falling over the Fourth of July holiday, is providing a meaningful "opportunity" to comment.[5]

A. Thirty Second Delay Between the Entry of Orders is Unnecessary

The proposed rules provide that an auto ex order for any account in which the same person is directly or indirectly interested may only be entered at intervals of no less than thirty seconds between entry of each order for the same stock.

The Institute questions the purpose of and necessity for this feature of the proposed system and urges the NYSE to re-examine this aspect of the proposal. In a fast-moving market environment as we are experiencing today, where a security may move precipitously through multiple price levels, it is crucial that orders be executed quickly and with certainty. This will become even more important once decimalization is implemented. A mandatory delay of thirty seconds between the entry of auto ex orders for the same stock will frequently result in the market having moved away from the price at which a market participant is willing to transact in that stock. This will defeat the purpose of providing investors with a facility to automatically execute limit orders without the intervention of a dealer. Before this feature becomes part of NYSE Direct+, we recommend that the NYSE examine its impact on the NYSE market, especially for the most actively traded securities where investors need to respond quickly to changing market environments, and, absent compelling reasons for a delay, we recommend that the thirty second delay be eliminated or significantly reduced.

B. Orders Should be Allowed to be Broken Into Smaller Amounts

The proposed rules also provide that orders of greater than 1,099 shares may not be broken up into smaller amounts in order to receive an automatic execution. It is unclear from the Proposal what type of "order" the proposed rules are referring to. The Institute believes that it is important that the NYSE avoid adopting rules that could have unintended consequences on market participants. In particular, we question whether certain trading practices utilized by institutional investors would be encompassed by the proposed rules' requirement. For example, if an institution tells a broker to "work" a large order of an NYSE listed stock, can that broker utilize NYSE Direct+ to execute part or all of this order? The Institute requests clarification of what constitutes an "order" for purposes of the proposed rules and recommends that the type of trading practices described above not be considered orders for purposes of this aspect of the proposed rules.

C. Increase Maximum Order Size

Under the Proposal, an "auto ex" order is defined as a limit order of 1,099 shares or less. In the Market Structure Report of the NYSE's Special Committee on Market Structure, Governance and Ownership, the Committee recommended that the NYSE Board "stand ready" to adjust the initial parameters of NYSE Direct+ by increasing the maximum eligible order size as investor demand and market performance warrant.[6] The Institute strongly supports increasing the maximum number of shares that can be entered into NYSE Direct+. NYSE Direct+, in addition to another NYSE initiative, Institutional Xpress, is intended to expand the order execution choices available to investors. Institutional Xpress will accept orders at or above a minimum size of 15,000 shares for execution by institutions.[7] The Institute believes that the gap between the size of orders that can be entered into Institutional Xpress and NYSE Direct+ is too great and excludes a large number of orders that institutions typically place in the NYSE for execution, especially for smaller cap stocks, where 15,000 share orders are infrequently entered.

D. Price/Time Priority Rule Should be Established for NYSE Direct+

Under the proposed rules, an auto ex order will receive an immediate, automatic execution against orders reflected in the Exchange's published quotation. The proposed rules provide that the first contra side bid or offer at a particular price will be entitled to time priority but that after a trade clears the Exchange floor, all bids and offers at that price will be on parity with each other and will receive a split of executions in accordance with Exchange rules.[8]

As we have previously commented,[9] the Institute supports price/time priority within markets that would ensure that a limit order entered on a given market will be filled prior to a limit order on that same market that is entered at the same price but later in time. The Institute recommends that price/time priority be applied to NYSE Direct+. This would rectify, for example, a situation where a market participant would be able to participate on the contra side of an automatic execution even though another participant may have placed an order in the NYSE earlier in time.

E. Assure Representative Pilot Program

The Proposing Release states that the Proposal would be implemented at the outset as a pilot program in a limited number of stocks before being made available to all stocks and that the NYSE has not yet determined which stocks will be eligible for automatic execution under the pilot. The Institute supports implementing NYSE Direct+ as a pilot program until the NYSE and market participants have gained sufficient experience with the system to better gauge its impact on the listed market. However, the Institute recommends that the pilot should include securities representing a substantial portion of the NYSE market, e.g., the top 100 NYSE listed securities, with the remainder chosen from quintiles of NYSE securities. This would assure a pilot program representative of the NYSE market and would provide market participants, the NSYE and regulators with adequate experience on the impact of NYSE Direct+ on the listed market.

* * *

The Institute appreciates the opportunity to comment on the Proposal. Any questions regarding our comments may be directed to the undersigned at 202-326-5815 or to Ari Burstein at 202-371-5408.

Sincerely,

Craig S. Tyle
General Counsel

cc: Annette L. Nazareth, Director
Robert L.D. Colby, Deputy Director

Division of Market Regulation
Securities and Exchange Commission

Catherine R. Kinney, Group Executive Vice President
Edward A. Kwalwasser, Group Executive Vice President
Robert J. McSweeney, Senior Vice President, Market Surveillance
New York Stock Exchange

ENDNOTES

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,084 open-end investment companies ("mutual funds"), 479 closed-end investment companies, and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.879 trillion, accounting for approximately 95% of total industry assets, and over 78.7 million individual shareholders.

[2] Securities Exchange Act Release No. 42913 (June 8, 2000), 65 FR 37587 (June 15, 2000) ("Proposing Release").

[3] See, e.g., Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated April 20, 2000 (File No. SR-NASD-99-53) (Nasdaq Order Display Facility).

[4] See Section 19(b)(1) of the Securities Exchange Act of 1934.

[5] It also should be noted that the Proposal was not posted on the SEC's public website, which would have helped the public gain access to the Proposal in a more timely manner.

[6] Market Structure Report of the New York Stock Exchange Special Committee on Market Structure, Governance and Ownership, p. 36.

[7] According to the NYSE Market Structure Report, this minimum share threshold will be set at 25,000 shares for the first four months after the system is introduced.

[8] See NYSE Rule 72, Priority and Precedence of Bids and Offers.

[9] See Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated May 12, 2000 (File No. SR-NYSE-99-48) (SEC Market Fragmentation Concept Release).