



INVESTMENT  
TECHNOLOGY  
GROUP

390 Madison Avenue, New York, NY 10017  
Tel. 212.538.4000 www.itg.com

February 22, 2010

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

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

Dear Ms. Murphy:

Investment Technology Group, Inc. ("ITG") appreciates the opportunity to comment on the proposal by the Securities and Exchange Commission ("Commission" or "SEC") to amend certain regulatory requirements of the Securities Exchange Act of 1934 ("Exchange Act") that apply to non-public trading interest in National Market System ("NMS") stocks,<sup>1</sup> including so-called "dark pools" of liquidity (i.e., alternative trading systems ("ATs") that do not publicly display their quotations).<sup>2</sup> ITG is an independent agency brokerage and financial technology firm that partners with asset managers globally to improve performance throughout the investment process. ITG operates an ATS called POSIT® that conducts matches of non-displayed, unpriced orders from institutional investors and broker-dealers.

In the proposing release, the Commission indicates that the primary goals of its proposal are to enhance transparency by requiring ATs that selectively display actionable trading interest to disseminate that interest to the public, and to promote fair access to this type of trading interest.<sup>3</sup> As an operator of an ATs, we support these goals. Nevertheless, we think it is critically important that the Commission approach this area with targeted objectives and not simply because certain brokerage functions have become

---

<sup>1</sup> Rule 600(b)(47) of Regulation NMS defines "NMS stock" to mean any NMS security other than an option. 17 CFR 242.600(b)(47). Rule 600(b)(46) defines "NMS security" to mean any security for which trade reports are made available pursuant to an effective transaction reporting plan. 17 CFR 242.600(b)(46).

<sup>2</sup> See Exchange Act Release No. 60997 (Nov. 13, 2009), 74 FR 61208 (Nov. 23, 2009).

<sup>3</sup> See, e.g., 74 FR at 61210.



increasingly automated. Mere automation by ATSS of traditional brokerage functions such as searching anonymously for liquidity for customer orders should not raise concerns for the Commission. There would be substantial drawbacks to restricting the activities of ATSS merely due to their automated nature, such as forcing clients to revert back to manual handling of orders and impeding the growth of execution venues suited to the changing needs of clients. At the same time, not all ATSS operate in the same manner, and we recognize that the Commission wants to address certain ATS practices that raise transparency issues. Although we believe that the proposal will help foster the Commission's stated objectives, we recommend certain changes to improve the operation of the proposed rules and address certain ambiguities contained in the Commission's proposed approach.

The Commission is proposing three changes to the rules under the Exchange Act that are designed to meet these objectives. The first change would amend the definition of "bid" or "offer" to include "actionable" indications of interest ("IOIs") shown by an ATS to a select group of market participants, so that such actionable IOIs would be deemed quotations under Regulation NMS and thus be subject to the quoting requirements in that regulation. The second change would lower the trading volume threshold in Regulation ATS that triggers the public display requirement for orders (including actionable IOIs) shown to more than one person by an ATS. The third change would amend the joint-industry plans of the self-regulatory organizations ("SROs") for the public dissemination of consolidated trade data to require real-time disclosure of the identity of an ATS (including a dark pool) on the reports of its executed trades.

## **I. Actionable IOIs**

### **A. The Commission's Proposed Amendments**

The Commission proposes to amend the definition of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS,<sup>4</sup> which currently excludes all IOIs, to exclude only IOIs that are not "actionable." Thus, an actionable IOI would need to be displayed in the public quote stream if it is disseminated by an entity required to display its quotes under Regulation NMS (e.g., an exchange, an ATS or an OTC market maker). The Commission does not propose to define an "actionable IOI" in any rule or regulation. Instead, it provides a description in the proposing release of when it believes an IOI would be considered "actionable." In this regard, the release states by way of example that an IOI would be considered actionable "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

---

<sup>4</sup> 17 CFR 242.600(b)(8).



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.”<sup>5</sup> The Commission also proposes 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.

#### B. ITG’s Comments

As the Commission recognizes in the proposing release, ATSs bring value to the marketplace by increasing competition.<sup>6</sup> As an operator of an ATS, ITG strongly believes that any Commission rulemaking in this area should promote rather than reduce the significant benefits that ATSs bring to the marketplace. ITG believes that the Commission’s proposal largely succeeds in this goal because it fosters transparency in ATSs that selectively display trading interest resembling quotations. An ATS that purports to be dark (*i.e.*, non-transparent), but actually displays actionable trading interest to multiple persons, is not truly dark. We understand and support the Commission’s objective of preventing the development of separate, private trading markets by treating as a quote those IOIs that convey sufficient actionable information about the symbol, side, size, and price of a specific trading interest.<sup>7</sup> An ATS that displays such actionable interest to multiple persons is in essence providing an internal quote to subscribers, and thus should be treated as such. At the same time, we strongly agree with the Commission that an ATS that is truly dark, in that it does not display an actionable IOI to more than one person, should continue to be exempt from the transparency requirements of Regulation ATS.<sup>8</sup>

While ITG supports the Commission’s objective of bringing actionable IOIs into the public quote stream, it believes that the Commission should provide a more precise and predictable definition of “actionable IOI.” The proposed amendment to include actionable IOIs in the definition of “bid” or “offer” has the effect of causing actionable IOIs to be quotations subject to various requirements in Regulation NMS, such as the

---

<sup>5</sup> See 74 FR at 61212. The Commission further provides that “[i]n 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.” *Id.*

<sup>6</sup> See, *e.g.*, 74 FR at 61215.

<sup>7</sup> See, *e.g.*, 74 FR at 61210.

<sup>8</sup> See, *e.g.*, 74 FR at 61216.



firm quote rule in Rule 602 of Regulation NMS,<sup>9</sup> as well as the trade-through rule in Rule 611 of Regulation NMS.<sup>10</sup> Although actionable IOIs are treated as quotations, they are not defined by the Commission in its proposal. Rather, the Commission provides an interpretation in the proposing release that would be used to determine whether IOIs are actionable. This interpretation would treat as an actionable IOI an IOI that includes symbol, side, price and size, whether explicit or implicit. In the Commission's view, implicit size could be any size of a round lot or greater and implicit price could be the NBBO or better. In addition, the Commission proposes that even if it is not clear that an IOI contains all of the four attributes of a quote, the Commission will use a facts and circumstances test to determine if an IOI should be treated as a quote (to prevent an entity from "end-running" the requirements).

ITG believes that the lack of certainty as to what constitutes an actionable IOI is unfair to the industry. This ambiguity could lead to unfair, post-hoc constraints or regulatory actions imposed on ATSS that have structured their IOIs in good faith to avoid having them be deemed actionable IOIs, only to learn later through a Commission or SRO inspection or other action that they were in fact actionable. The consequences for such an ATS could be severe because it could be found to have violated the firm quote and quotation display rules of Regulation NMS. Given the ambiguity in what constitutes an actionable IOI and the potentially severe consequences faced by an ATS that makes a mistake in this regard, ITG recommends that the Commission provide a definition or clear set of guidelines for what constitutes actionable IOIs.

ITG strongly supports an exception for block orders from the proposed Regulation NMS quoting requirements for actionable IOIs.<sup>11</sup> As the Commission notes in the proposing release, such an exception is necessary to enable investors to trade more efficiently in sizes much larger than the average size of trades in the public markets.<sup>12</sup> ITG agrees with the Commission and notes that managing information leakage with respect to block orders is always an issue, especially in the pre-trade period. ITG believes that an exception from the proposed Regulation NMS quoting requirements for large actionable IOIs is critically important in allowing investors to prevent information leakage with respect to block orders in the pre-trade period.

---

<sup>9</sup> 17 CFR 242.602.

<sup>10</sup> 17 CFR 242.611.

<sup>11</sup> ITG similarly supports an exception for block orders from the proposed Regulation ATS public display requirement for orders.

<sup>12</sup> See, e.g., 74 FR at 61210.



ITG therefore urges the Commission to adopt an exception for block orders, but requests that the Commission modify its definition of what constitutes a block order, which the Commission has proposed to define as an order (or actionable IOI) with a market value of \$200,000 or more.<sup>13</sup> In creating this definition, the Commission decided not to follow the existing definition of “block size” in Rule 600(b)(9) of Regulation NMS, which covers orders for at least 10,000 shares and orders for a quantity of stock having a market value of \$200,000 or more.<sup>14</sup> The Commission stated that it made this decision because it does not believe an exemption for an order for 10,000 shares of a low-priced stock would be appropriate - in its view, the proposed size discovery exclusion should be limited to “truly large size orders.”<sup>15</sup>

ITG agrees that the exception should apply only to truly large size orders, but believes that the Commission’s proposed definition is only a rough approximation of what constitutes a block order for a particular stock. In this regard, a one-size-fits-all model does not take into account the costs and liquidity associated with executing trades in different stocks. For example, for a \$20 stock that averages 150,000 shares per day, a \$200,000 trade easily would constitute a block trade. Indeed, a \$100,000 trade in that stock might reasonably be deemed a block. In contrast, a \$200,000 trade does not seem to us to be a large trade in a \$20 stock that averages 3 million shares per day.

We believe that a reasonable proxy for the costs and liquidity associated with executing large orders in a stock is a percentage of the average daily volume (“ADV”) of that stock. At the same time, we recognize that even a small percentage of the ADV of a very active stock could constitute a very large order. Accordingly, we suggest that the Commission define a block order as an order for the lesser of \$200,000 of a stock or 1% of the dollar value of ADV of that stock. We suggest that the dollar value of ADV be calculated on a quarterly basis because the volume of a stock can change over time.<sup>16</sup> For

---

<sup>13</sup> ITG also requests that the Commission modify in the manner discussed above its definition of a block order used in connection with the proposed Regulation ATS public display requirement, and its definition of block trade used in connection with the proposed trade report attribution requirement for ATS trades.

<sup>14</sup> 17 CFR 242.600(b)(9). This definition is used to exclude block size orders from the display requirements in Rule 604 of Regulation NMS (the limit order display rule). 17 CFR 242.604.

<sup>15</sup> See 74 FR at 61213.

<sup>16</sup> The Commission has used a similar approach in other areas. For example, an OTC market maker that has executed more than 1% of the reported volume of an exchange-



example, a block order under our suggested definition for a \$20 stock that has a dollar value of ADV of \$40 million during the most recent quarter (*i.e.*, an ADV of 2 million shares a day during the quarter) would be an order for \$200,000 of that stock, rather than an order for 1% of the dollar value of ADV of that stock (*i.e.*, an order for \$400,000 of that stock). A block order under our suggested definition, however, for a \$20 stock that has a dollar value of ADV of \$10 million during the most recent quarter (*i.e.*, an ADV of 500,000 shares a day during the quarter) would be an order for \$100,000 of that stock (*i.e.*, an order for 1% of the dollar value of ADV of that stock). We believe that our suggested definition better reflects the costs and liquidity associated with executing large orders in less traded stocks than the Commission's proposed definition.

Overall, we believe that a definition that takes into account the ADV of a stock would be the best test for determining a block transaction. If the Commission, however, does not want to use an approach that has a different share threshold for each stock, we suggest that the Commission define a block order through a tiered definition, such that a block order for a high volume stock would be an order with a value of \$500,000 (or an order for 25,000 shares), a block order for an average volume stock would be an order with a value of \$200,000 (or an order for 10,000 shares), and a block order for a low volume stock would be an order with a value of \$100,000 (or an order for 5,000 shares). We believe that this alternative definition, while not as precise as the definition we have suggested above, would be a more accurate way for defining a block order than what the Commission has proposed.<sup>17</sup>

ITG also urges the Commission to clarify that the block exception condition that there be contra-side trading interest of \$200,000 is satisfied if the aggregate amount of the contra-side interest would constitute a block order, and not that a single contra-side interest of \$200,000 or more exists. For example, if the Commission were to issue such guidance, an ATS that receives an order to buy \$300,000 worth of stock could send out IOIs to three different sources of liquidity in the ATS, each displaying \$100,000 of that stock to sell, without being subject to the proposed Regulation NMS quoting requirement for actionable IOIs. We believe that such guidance is consistent with the Commission's rationale for its proposed exception for block-sized IOIs from the firm quote rule, and

---

traded security during the most recent calendar quarter is subject to the firm quote rule in Regulation NMS with respect to that security. See 17 CFR 242.602(a)(1)(ii).

<sup>17</sup> If the Commission were receptive to one of our definitions, we also recommend that it use this rulemaking as an opportunity to adopt a consistent definition of block order (and block trade) throughout Regulation NMS and Regulation ATS. This would have the effect of making the limit order display requirements in Regulation NMS consistent with the proposed requirements in this rulemaking.



consistent with the manner in which block orders are traded.

## **II. ATS Public Display Requirement**

### **A. The Commission's Proposed Amendments**

Currently, Rule 301(b)(3) of Regulation ATS requires an ATS that displays orders in an NMS stock to more than one person, and that has 5% or more of the average daily trading volume ("ADTV") of that stock for four of the preceding six calendar months, to display orders in that stock in the public quote stream and to provide execution access to those orders.<sup>18</sup> The Commission proposes to lower this threshold from 5% to 0.25% of the ADTV of any NMS stock. In connection with this change, the Commission is proposing to change the language of Rule 301(b)(3)(ii) to make clear that ATS orders (including actionable IOIs) that are displayed to more than one person, whether inside or outside of the ATS, are subject to the display obligation.<sup>19</sup> The Commission also proposes to amend Rule 301(b)(3)(ii) of Regulation ATS to exclude from the order display requirements of Regulation ATS orders having a market value of \$200,000 or more that are displayed only to those who are reasonably believed to represent current contra-side trading interest of at least \$200,000. This is intended to make the rule consistent with the proposed exception for similar large-sized orders from the definition of bid or offer, discussed above.

### **B. ITG's Comments**

ITG does not oppose the proposed amendment to reduce from 5% to .25% the trading volume threshold that triggers the Regulation ATS public display requirement. As noted above, however, we strongly believe that an ATS that does not display its orders to more than one person should be exempt from the ATS transparency requirements. An ATS that does not display its orders is not creating a separate private market with displayed interest. Accordingly, it has no "quotes" or actionable IOIs to display. The Commission correctly recognizes that completely non-transparent ATSs offer a useful and effective tool for certain investors and should continue to be a viable alternative liquidity source for those investors.<sup>20</sup>

---

<sup>18</sup> 17 CFR 242.301(b)(3).

<sup>19</sup> 17 CFR 242.301(b)(3)(ii).

<sup>20</sup> See, e.g., 74 FR at 61216.



Along these lines, ITG believes that the Commission should clarify that the proposed ATS public display requirement in Rule 301(b)(3)(ii) does not apply to orders residing in a broker-dealer's ATS that choose to interact with one or more of that broker-dealer's smart routers, trading algorithms, or both, provided the ATS, smart routers and trading algorithms all are housed within the same corporate entity. In this regard, the proposed amendment to Rule 301(b)(3)(ii) would require an ATS to provide for public display the prices and sizes of orders (except for block orders) that are "displayed to more than one person (other than alternative trading system employees)." The term "person" is defined in Section 3(a)(9) of the Exchange Act as "a natural person, company, government, or political subdivision, agency, or instrumentality of a government." Thus, if a broker-dealer's ATS, smart routers, and trading algorithms all are housed within the same corporate entity, and orders residing in that ATS interact only with those smart routers and trading algorithms, we believe that such orders should not be subject to the proposed display requirement in Rule 301(b)(3)(ii) because they are not being displayed to any "persons" as that term is defined in Section 3(a)(9) of the Exchange Act other than the operator of the ATS.

ITG believes that clarification in the form of a specific exception in Rule 301(b)(3)(ii) for such orders would be consistent with the goal in Section 11A(a)(1)(C)(i) of the Exchange Act, which provides that the national market system for securities should assure "economically efficient execution of securities transactions." Broker-dealers with ATSS, smart routers, and trading algorithms in the same corporate entity frequently have their smart routers and trading algorithms check their ATSS for contra-side interest prior to routing orders out to the marketplace. Such broker-dealers engage in this practice because they are able to obtain better executions of their customers' orders by avoiding the delay, transaction costs, and information leakage associated with sending their customers' orders out to the marketplace for execution. Those orders are not displayed to third party persons who can act on them, and thus no separate, private trading market is created (in contrast to actionable IOIs that are displayed to multiple persons).

Accordingly, ITG recommends that the Commission provide clarification on this point in the manner described above. If the Commission is concerned about the use of smart routers or trading algorithms by broker-dealers to internalize order flow (*i.e.*, broker-dealers that use proprietary orders to fill customer orders) without exposure to the market, we recommend that the Commission limit the interpretation that a broker-dealer's internal systems do not constitute a person to those systems that execute their customers' orders on an agency basis only.

While not directly addressed by this proposed rulemaking, ITG also recommends that the Commission examine private links between two or more broker-dealers that allow a participating broker-dealer's smart routers and trading algorithms to search for



liquidity at participating broker-dealers or other persons. Frequently, such smart routers and trading algorithms send IOIs through these links that would be deemed to be actionable IOIs under the proposing release. As we read the proposed rules, such actionable IOIs would not be subject to any public display requirements unless they are sent by the market making desks of the participating broker-dealers (i.e., the “OTC market maker” units of the participating broker-dealers).

In fact, we believe that these types of private links could potentially be used to avoid the proposed rules entirely by allowing the smart routers or trading algorithms at participating broker-dealers to negotiate a transaction and then place an order in a predetermined ATS of one of the participating broker-dealers for execution against pre-arranged contra-side interest. For example, two broker-dealers (who are not market makers) could establish a direct link where actionable IOIs are disseminated to each firm and, if they result in a match, are sent as a cross trade for immediate execution to an ATS affiliated with one of the firms. As another example, a broker-dealer could implement bilateral links with different hedge fund clients where actionable IOIs are disseminated and, if a match results, a cross trade with the broker-dealer is effected on a non-affiliated ATS. As we read the SEC’s proposal, such actionable IOIs would not be subject to any public display requirements under the Commission’s proposed rules. Accordingly, we believe that examination of this type of activity by the Commission would be consistent with its stated goal in the proposing release of promoting transparency of dark trading interest.

### **III. Trade Report Attribution of ATS Trades**

#### **A. The Commission’s Proposed Amendments**

The Commission proposes to amend the joint-industry plans to require real-time disclosure of the identity of an ATS (including a dark pool) on the reports of its executed trades. Trades executed in ATSs are reported to the consolidated tape streams through one of the trade reporting facilities (“TRFs”) operated by FINRA on behalf of exchanges or through FINRA’s Alternative Display Facility (“ADF”). Currently, published trade reports for these trades identify them only as OTC trades, and they do not identify the particular ATS or the broker-dealer sponsor of the ATS where the trade was executed, unlike trade reports for executions on exchanges, which do specify the exchange on which the trade was executed. The Commission’s proposal would change this by requiring the identifier of an ATS on the ATS’ submission of an execution report to the tape so that the identification of the ATS as the execution venue of a transaction would be displayed on the consolidated tape. Similar to the exceptions discussed above, the Commission also proposes to exclude from this ATS attribution requirement trade reports of trades with a value of \$200,000 or more.



B. ITG's Comments

ITG supports amendments to the joint-industry plans to require disclosure of the identity of the ATS on the reports of its executed trades, but believes that such disclosure should be done on a delayed basis such as the end of the day. ITG is concerned that including the identity of an ATS on its trade reports on a real-time basis may allow persons to take advantage of large orders being executed on that ATS. In this regard, institutional investors frequently execute large orders in smaller pieces through an ATS or other venues to avoid tipping off high frequency traders to the existence of those large orders. Such investors employ this type of strategy in part because the anonymity of the trade reports for the pieces executed on the ATS makes it difficult to discern execution patterns for persons seeking to take advantage of those large orders. ITG believes that the Commission's proposal to require disclosure on a real-time basis of the identity of the ATS on its trade reports may allow such persons to take advantage of large orders.

Accordingly, ITG requests that the Commission modify its proposal to require such disclosure on a delayed basis such as the end of the day. ITG believes that such disclosure, even on a delayed basis, will help foster transparency in the ATS marketplace, and will provide investors and broker-dealers with valuable information about the location of liquidity sources and the execution destinations of orders. Such information would help promote a national market system that enables vibrant competition by multiple ATSs, yet unifies execution information in a truly meaningful manner. We are unpersuaded that disseminating the post-execution identity of an execution venue will disadvantage investors whose orders are executed in an ATS if it is done on a delayed basis.

ITG understands that some in favor of delayed reporting of the identity of the ATS have suggested that the ATS report on a delayed basis all the execution reports for a particular stock effected on that ATS on an aggregated basis (*i.e.*, one number showing the total volume of trades executed in a particular stock on that ATS). However, ITG strongly believes that such information should be reported on a disaggregated basis (*i.e.*, a report showing each trade executed on that ATS) to provide the marketplace with the maximum amount of information. It will be virtually impossible for investors and the marketplace to measure and analyze the performance of an ATS unless trade by trade identification of an ATS is available. Aggregated data for an entire day's trading in a stock by an ATS does not provide much information of use to the marketplace and is contrary to the Commission's stated goal of enhancing transparency of dark pool executions. Indeed, in the Concept Release on Equity Market Structure recently issued by the Commission, the SEC seeks comment on whether the trading volume of dark pools has reached a sufficiently high level as to detract from the quality of public price



discovery and execution quality.<sup>21</sup> ITG believes that there is no meaningful way to answer this question without the ability to analyze the quality of executions effected on ATSs on an execution by execution basis.

In two respects, ITG does not believe that the Commission's proposed trade reporting amendments go far enough in promoting transparency in the ATS marketplace. First, the Commission has proposed to exclude a trade with a value of \$200,000 or more from the requirement to report it in real-time with the name of the ATS on which the trade was effected.<sup>22</sup> ITG supports this exclusion, and agrees with the Commission that the disclosure of the identity of the ATS in this situation on a real-time basis could potentially cause undue information leakage about a large order.<sup>23</sup> ITG, however, does not believe that information regarding large trades should be permanently hidden from the marketplace, as such information is valuable to market participants and necessary for all forms of transaction cost analysis, including best execution. ITG therefore recommends that the Commission amend the joint industry plans to require the reporting of the identity of the ATS that executed a block trade on a delayed basis at the end of the day, with the reports identifying the stock, the ATS on which the trade was executed, the time of execution, and the number of shares.

Second, ITG recommends that the Commission consider amending the joint industry plans to require reporting of the identity of all participants who effect executions, and not just exchanges and ATSs. This suggestion would provide additional transparency to the marketplace and promote equal treatment of execution venues. As we note in the second paragraph of this letter, the Commission should not single out automated systems for new obligations merely due to their automated nature, but should strive to treat all market participants equally.

---

<sup>21</sup> See Exchange Act Release No. 61358 (Jan. 14, 2010), 75 FR 3594 (Jan. 21, 2010).

<sup>22</sup> We recommend that the Commission modify this definition of block trade in the manner discussed above.

<sup>23</sup> See 74 FR at 61219.



#### **IV. Conclusion**

ITG appreciates the opportunity to comment on the Commission's proposal. While we support the proposal overall, we believe that the changes we have suggested above will improve the proposal by furthering its transparency and fair access purposes. If you have any questions related to our comment letter, please feel to contact me.

Sincerely,

A handwritten signature in black ink that reads "P. Mats Goebels".

P. Mats Goebels  
Managing Director and General Counsel  
Investment Technology Group, Inc.