INVESTMENT COMPANY INSTITUTE

MATTHEW P. FINK
PRESIDENT

ES8/57/

October 13, 1999

Arthur Levitt
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Changes in the Securities Markets

Dear Chairman Levitt:

The Investment Company Institute[1] applauds your excellent speech, *Dynamic Markets, Timeless Principles*, on the enormous changes occurring in the securities markets. Investment companies, as the vehicles through which millions of investors participate in the U.S. securities markets, have a keen interest in seeing that the markets are highly competitive, transparent and efficient. We strongly supported previous initiatives -- such as the adoption of the Order Handling and Alternative Trading System rules -- that have promoted competition, innovation and price transparency, and reduced price spreads and execution costs in the markets.

We agree with you that it is important for regulators and market participants to begin discussing ways to address the significant issues and challenges that lay ahead as the markets continue to rapidly evolve. We offer our assistance to you and your staff as you consider those issues. In addition, we offer for your consideration our preliminary views on several issues discussed in your speech: demutualization, ECN fees and centrality.

Demutualization. As you noted, Nasdaq's and the NYSE's plans to become for-profit enterprises raise several issues including, in particular, what changes to the current system of self-regulation are needed. While we do not have any definitive view at this time as to the best approach, we agree that there should be a strict separation of the self-regulatory role from the marketplace it oversees and that the self-regulatory standards in place today not be weakened. Accordingly, the Institute was pleased that you made clear that any regulatory restructuring that is implemented "must ensure that the self-regulatory obligation be vigorously fulfilled, adequately funded, and dedicated to serving the public interest."

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,733 open-end investment companies ("mutual funds"), 483 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.009 trillion, accounting for approximately 95% of total industry assets, and have over 73 million individual shareholders.

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We were particularly pleased that you stressed the need for continued stringent listing standards. In addition to policing the activities of their members, the SROs impose substantive standards on their listed companies that are designed to promote market integrity and investor protection (*e.g.*, the NYSE's policy regarding listed company stock option plans). Any dilution of those standards as a result of the demutualization of Nasdaq and the NYSE and their increased competition with each other for new business would be detrimental to investors.[2] In exploring the future regulatory structure of the markets, we urge the Commission to give this issue serious consideration, including whether it might be appropriate for a single SRO or even for the Commission itself to establish those standards.

Demutualization of Nasdaq and the NYSE raises another concern, which stems from the overwhelming dominance that Nasdaq and the NYSE currently enjoy in the marketplace. Their dominant positions are likely to persist for some time after they become for-profit enterprises. This in turn might provide Nasdaq and the NYSE both an incentive and an opportunity to raise their fees to inappropriate levels. Therefore, we urge the Commission to monitor vigilantly those fee levels and approve only justified fee increases. To the extent that the "exchange marketplace" becomes less oligopolistic, the Commission's active involvement in this area could decrease correspondingly.

ECN Fees. As recognized in your speech, ECNs "have been one of the most important developments in our markets in years -- perhaps decades." We strongly concur and support the Commission's two-fold approach to ECNs that you outlined -- providing regulatory space for competition while seeking to ensure market integrity and a level playing field for all markets. We urge that any regulation of ECN fees be consistent with that approach. Specifically, it must be recognized that ECNs differ in certain respects from traditional market makers. A market maker typically earns the spread between the bid and offer for a particular security. In contrast, an ECN collects what can best be characterized as a service fee in connection with the execution of a transaction. To ensure a level playing field and to avoid stifling competition, it is important that any regulatory proposals relating to ECN fees do not unfairly discriminate against certain classes of market participants by restricting only certain types of compensation.

Centrality. We agree with your assessment that fragmented markets are detrimental to liquidity, tighter spreads and overall efficiency. For this reason, we support efforts to facilitate the ability of customer orders to interact with one another as broadly as possible. One such effort is Nasdaq's proposed limit order book, which we have strongly supported.[3] Such a limit order book may be especially important in

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[2] Competition between them will likely increase even more if NYSE Rule 390 is repealed.

[3] *See* Release No. 34-39718 (March 12, 1998) (proposing a central limit order file for the Nasdaq market) and Release No. 34-41296 (April 15, 1999) (reopening the comment period for that proposal). *See* Letters from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated June 1, 1999 and May 8, 1998 (File No. SR-NASD-98-17) (commenting on the proposed central limit order book).

promoting liquidity and transparency in after-hours trading sessions. Another possible change that is at least worthy of serious consideration is enhancing the Intermarket Trading System.

At the same time, the Institute is sensitive to the potential conflict between efforts to reduce market fragmentation through greater centrality of orders and the need to promote competition and innovation. But the Commission should not allow legitimate concerns over fragmentation to serve as a facade for efforts to monopolize all or part of our markets.

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The Institute appreciates the opportunity to submit its preliminary views on these important issues. We commend you for your continued leadership in this area and look forward to working with you in the future.

With best regards,

Matthew P. Fink
President

cc: Annette L. Nazarath, Director
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