

## Comment Letter on Nasdaq Order Display Facility, January 2000

January 11, 2000

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

**Re: Order Display Facility (File No. SR-NASD-99-53)**

Dear Mr. Katz:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the proposed rule change<sup>2</sup> filed by the National Association of Securities Dealers ("NASD") through its wholly-owned subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), to improve the Nasdaq quotation montage by creating a new facility for the display of trading interest (the "Nasdaq Order Display Facility"). The proposed rule change also would modify Nasdaq's pending proposals to integrate its Small Order Execution System ("SOES") and SelectNet system<sup>3</sup> and to permit the separate display of customer orders by market makers through a market maker agency identification symbol ("Agency Quote").<sup>4</sup>

As we stated in our comment letters on the above mentioned pending Nasdaq proposals and the Nasdaq proposal to establish a limit order book,<sup>5</sup> the Institute strongly supports modifications to Nasdaq's quotation montage and trading platforms.<sup>6</sup> Our members, who are investors of over \$6 trillion of assets for over 78 million individual shareholders, have a keen interest in ensuring that the Nasdaq market is made more open and fair and have strongly supported past regulatory efforts to improve the quality of the U.S. markets.<sup>7</sup> More specifically, steps to enhance order interaction would be very beneficial to funds and their shareholders. Funds currently must often look to several different sources to find liquidity to effectively complete a trade at the best price. Creating a system that provides investors with greater access to all priced orders and allows them to execute against those orders would greatly enhance the quality of the Nasdaq market. The Institute therefore supports the objectives of the proposal to establish the Order Display Facility and to modify Nasdaq's trading platforms. Nevertheless, the Institute believes that there are certain aspects of the proposal that require further examination before the SEC approves the proposal.

Our specific comments on the proposed rule change follow below. Given the complexity of the rule change and its importance to the operation of the Nasdaq market, the Institute will continue to examine the proposal and will submit additional comments if necessary.

### Nasdaq Order Display Facility

Under the proposal, Nasdaq would add the Order Display Facility to the top portion of the Nasdaq Workstation II. The Order Display Facility would display the three best price levels in Nasdaq, as well as the aggregate size at each price level of the "displayed" trading interest of market makers, electronic communication networks ("ECNs"), and Unlisted Trading Privilege ("UTP") Exchanges. The Institute believes that given the recent volatility in the securities markets, combined with the planned conversion from fractional pricing to decimal pricing, the Order Display Facility should instead display the five best price levels in Nasdaq on both the bid and offer side of the market. Displaying five price levels would provide investors with a greater indication of the interest in a particular security and would allow investors to better gauge the market in general. This will be crucial in a fast moving market environment, especially once decimalization becomes effective.

#### Five-Second Rule

Under the proposed order execution algorithm, once displayed and reserve size in Nasdaq is exhausted at a certain price level and the system has attempted to access the quotes of UTP Exchanges at that price level, the Nasdaq system would then move to the next price level. There would, however, be a five-second delay before the system would attempt to execute any orders at that time. The Proposing Release states that this delay will give market participants time to adjust their quotes and trading interests before the

market moves precipitously through multiple price levels, which may occur when there is news, rumors, or significant market events, and that Nasdaq believes that the delay is a modest and reasonable attempt to limit volatility.

The Institute believes it is unclear at this time what the ramifications of the proposed five-second delay would be to the Nasdaq market and whether this delay would, in fact, reduce market volatility. Before this feature becomes part of the Nasdaq market, we recommend that Nasdaq further examine its impact on the Nasdaq market, especially for the most actively traded securities where investors need to respond quickly to a changing market environment.

## Internalization

Under the proposed system, when a Nasdaq Quoting Market Participant is at the best bid/best offer, Nasdaq would provide for internal matching of that participant's orders against the participant's quotes/order before the order is sent into the Nasdaq system to execute against all non-directed orders.

The Institute believes that the internalization of orders can impede access to liquidity for market participants, especially if significant amounts of a particular security's daily volume is internalized. In addition, if a significant amount of orders in a particular security are internalized, it is debatable whether there is true price discovery for that particular security. The Institute therefore questions the added benefit of this feature to the proposed Nasdaq system and urges Nasdaq to re-examine this aspect of the proposal.

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The Institute appreciates the opportunity to comment on these very important proposals. Any questions regarding our comments may be directed to the undersigned at 202-326-5815.

Sincerely,

Craig S. Tyle  
General Counsel

cc: Annette L. Nazareth, Director  
Robert L.D. Colby, Deputy Director  
Division of Market Regulation

Paul F. Roye, Director  
Division of Investment Management  
Securities and Exchange Commission

Richard G. Ketchum, President  
National Association of Securities Dealers, Inc.

S. William Broka, Senior Vice President  
The Nasdaq Stock Market, Inc.

### ENDNOTES

<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,004 open-end investment companies ("mutual funds"), 494 closed-end investment companies, and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.404 trillion, accounting for approximately 95% of total industry assets, and over 78.7 million individual shareholders.

<sup>2</sup> Securities Exchange Act Release No. 42166 (November 22, 1999), 64 FR 68125 (December 6, 1999) ("Proposing Release").

<sup>3</sup> Securities Exchange Act Release No. 41296 (April 15, 1999), 64 FR 19844 (April 22, 1999).

<sup>4</sup> Securities Exchange Act Release No. 41128 (March 2, 1999), 64 FR 12198 (March 11, 1998).

<sup>5</sup> Securities Exchange Act Release No. 39718 (March 4, 1998), 63 FR 12124 (March 12, 1998).

<sup>6</sup> See Letters from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated May 8, 1998 (File No. SR-NASD-98-17) and June 1, 1999 (File Nos. SR-NASD-99-11, SR-NASD-99-09, and SR-NASD-98-17).

<sup>7</sup> See, e.g., Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities

and Exchange Commission, dated July 28, 1998 (File No. S7-12-98) (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 September 2, 1998 (File No. 4-208) (Proposals to amend the operations of the Intermarket Trading System).

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