

# **Trading Stocks in America: Key Policy Issues**

## **Trading and Market Structure Issues from the Buyside Perspective**

**The Brookings Institution**

**January 30, 2014**

**Ari Burstein, Senior Counsel - Capital Markets  
Investment Company Institute**

# About Investment Company Institute



## About ICI Membership

---

- ICI members are comprised of U.S. registered investment companies, their investment advisers, and their principal underwriters
- Mutual fund members of the ICI have total assets of approximately \$16.3 trillion representing 98 percent of all assets of US mutual funds
- These funds serve approximately 96 million shareholders in nearly 57 million households

## Buy-side Views on the Status of the Markets

- Structure of the markets and trading continues to evolve very quickly
- Advancements overall have benefited investors
  - Lower overall trading costs; technology has increased efficiency; greater control over trades; and increased number and variety of trading tools
  - BUT several issues remain .....
- In general, difficult for regulations (and regulators) to keep pace with technological advancements
- Remains a general lack of understanding of unique issues impacting funds

## Key Regulatory Issues Relating to Trading and Market Structure

- Impact of use of “dark liquidity” and the “lit market” vs. “dark market” debate
- Addressing potential conflicts of interest in order routing and order execution
- Investments in small-cap stocks/decimalization/tick sizes
- Technology and associated market risks
  - High frequency trading, algorithms, and automated trading

## Challenges for Regulators and Policymakers When Examining Trading Issues

- Need to base decisions on evidence and research
- Protection of what investors? retail, institutional, or both
- Promoting competition while ensuring transparent and liquid markets
- Allowing innovation while ensuring safety and soundness of the markets
- Promoting capital formation in complex markets

## Use of “Dark Liquidity” and the “Lit Market” vs. “Dark Market” Debate

- Examination continues of the impact of dark liquidity and dark pools on the markets
- Challenges
  - Determining the impact of dark liquidity on price discovery and liquidity
    - Is dark trading actually harmful to investors?
  - Obtaining accurate data for percentage of trading occurring in the dark
  - Determining how to promote more trading in the lit markets
- Implications for fund trading?

## Use of “Dark Liquidity” and the “Lit Market” vs. “Dark Market” Debate

- Funds are significant users of undisplayed liquidity
- ICI recognizes concerns about potential impact on price discovery process and liquidity in the “lit” markets
- ICI supports:
  - Efforts to provide incentives for market participants to use lit markets while allowing undisplayed liquidity to remain available
  - Exceptions for pre- and post-trade transparency for large orders
  - Increasing information available to market participants about how orders are routed and executed

## Addressing Potential Conflicts of Interest in Order Routing and Order Execution

- Have economics, as opposed to price, become the focal point in routing and execution
  - Liquidity rebates
  - Order types
  - Access fees
  - Internalization
- Need to determine the impact on liquidity and price discovery
- Examining regulatory reforms to address concerns
  - Is transparency the solution?

## Addressing Potential Conflicts of Interest in the Routing and Execution of Orders

- Developments
  - ICI Meetings with market participants
    - Increase and standardize market information
  - FINRA ATS transparency proposal
  - Pilot program on rebates, access fees?
  - Development of new trading venues

## Decimalization/Small-Cap Stocks/Tick Sizes

- Arguments for Reform/Challenges for Regulators
  - Need to increase liquidity in small-cap stocks
  - Need to spur more capital formation in the markets
  - Need to increase research for certain stocks
- Developments
  - US legislation; Equity Capital Formation Task Force Report to U.S. Department of the Treasury; Citi Letter; Subcommittee of SEC Investor Advisory Committee
- Is a pilot program on the horizon?

## High Frequency Trading, Automated Trading and Role of Technology

- Technological developments have had a significant impact on the manner in which funds trade (HFT, use of algorithms, number and types of alternative trading venues available)
- Continued focus on technology after numerous high-profile disruptions to the markets
- Challenges for regulators
  - How to manage systemic risks and ensure safe markets while encouraging use of technology
  - How to ensure investor confidence while allowing innovation

## High Frequency Trading, Automated Trading and Role of Technology

- HFT: basic and fundamental questions still need to be addressed: What is HFT? Who are high frequency traders? What role do they play in the markets?
  - Need to obtain accurate, timely and detailed data
  - Need for enhanced surveillance capabilities, prevent abusive and manipulative behavior, and clarity between legitimate and disruptive practices
- Need for strong but sensible regulation

## Further Information on ICI and ICI Global

---

- [www.ici.org](http://www.ici.org)
- [www.iciglobal.org](http://www.iciglobal.org)
- [www.icifactbook.org](http://www.icifactbook.org)

**Ari Burstein, Senior Counsel - Capital Markets**

**Investment Company Institute and ICI Global**

**1401 H Street, N.W.**

**Washington, D.C. 20005-2148**

**[aburstein@ici.org](mailto:aburstein@ici.org); 1-202-371-5408**