



Securities Industry Association

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May 10, 2000

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

Re: File No. 4-430

Dear Mr. Katz,

The Securities Industry Association ("SIA")¹ is pleased to offer its comments in response to the above-referenced notice relating to decimal implementation schedules. The SIA shares the commitment of the SEC to implement decimal pricing of securities in a timely and responsible fashion and appreciates the careful way the Commission has guided the industry toward decimalization.

Prior to the announcement that Nasdaq would be unable to meet the July 3 date for the commencement of trading in decimals, SIA had developed a three-phase conversion plan that included testing prior to each phase. The Nasdaq announcement has not given us reason to change the fundamentals of that approach. On March 21, SIA responded to a letter from Chairman Levitt requesting information on the feasibility and advisability of allowing trading of securities in both decimals and fractions.² In that letter, SIA strongly recommended that all markets convert at the same time and that it was inadvisable to proceed with decimal trading in listed securities while Nasdaq securities continued to be traded in fractions. SIA did indicate that if Nasdaq were able to accommodate trading in listed securities, it might be technically possible to trade listed securities in decimals and Nasdaq securities in fractions.

The current SEC release raises one alternative that was included in the Chairman's letter as well as a new alternative. SIA's response (described in detail below)

¹ The SIA The Securities Industry Association brings together the shared interests of more than 740 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans. The industry generates more than \$300 billion of revenues yearly in the U.S. economy and employs more than 600,000 individuals.

reflects SIA's support for a pilot program for decimal trading of 30 or fewer listed securities beginning September 4. SIA reaffirms its support for the phased-in approach of the original plan and continues to find inadvisable any plan for a fully bifurcated environment in which *all* listed securities trade in decimals and *all* Nasdaq securities trade in fractions.

QUESTION #1:

Is it feasible to begin Dual Pricing by September 4, 2000? If it is feasible, should trading in all exchange-listed securities be in nickel or penny increments? If it is not feasible to begin Dual Pricing by September 4, 2000, why not?

ANSWER: SIA does not believe it is advisable for the industry to pursue a Dual Pricing by September 4.³

SIA's discussions with industry participants have concluded that dual pricing (full bifurcation) would not be advisable because of the difficulty of creating and maintaining separate processes, systems, programs, and procedures for both decimals and fractions. Dual pricing would also require a massive educational effort directed at the investing public to assist them in distinguishing listed versus Nasdaq securities.

In its March 13 letter to Chairman Arthur Levitt, SIA discussed in greater detail the problems that would be inherent in proceeding with dual pricing. Dual pricing represents a major change to SIA's implementation phased-in plan in the following ways⁴:

- Phase One of the original plan called for the processing of 30-40 securities in decimals while all others remained in fractions. SIA determined that a phased-in approach was the best course of action in order to be able to study the effects of decimal trading and take appropriate and timely measures to correct any that threatened investor protection and efficiency. Dual pricing, however, would significantly broaden and accelerate the innumerable operational changes contemplated by the original plan. Safety and soundness would not only be compromised by the lack of a phase-in, but would be further compounded by the extensive changes that would have to be performed once again when Nasdaq is ready to convert.

³ For purposes of consistency, SIA understands the term "Dual Pricing" in the SEC release to refer to a proposal to trade all listed securities in decimals beginning September 4. This proposal is also sometimes referred to as "full bifurcation."

⁴ See also letter from Arthur Levitt, Chairman, SEC, to Representative Thomas J. Bliley, Jr. dated April 7, 2000, expressing similar investor protection and system concerns.

- Pricing edits would have to be built to recognize which securities are trading in fractions vs. decimals by exchange. This is a significant development effort for the firms and service bureaus as this process does not currently exist.
- Dual Pricing would create serious problems for options market professionals that will have to deal with securities in fractions and decimals in the same public outcry environment. For example, an options market maker could receive a large number of trades in both decimals and fractions simultaneously.
- Self-directed (i.e., internet) order entry will be greatly affected. Investors often enter orders without regard to the exchange a security is traded on. An investor that fails to monitor the status of an order may be unaware that a mispriced order has been rejected.
- Dual Pricing will cause the industry to encounter at least two phases of implementation, testing, and conversion. The costs associated with each of these elements will be exacerbated accordingly.
- The July 3rd target date was always considered to be aggressive. The original plan was to complete testing by late May and then assess the industry's readiness. At that juncture, the Industry Evaluation Team, comprised of members of the markets, broker/dealers, and regulators would make its recommendation to proceed based on the results of testing. We expect this logical approach to carry forward regardless of the implementation date.
- Market data and infrastructure readiness are critical components of a successful conversion. Before Securities Industry Automation Corporation (SIAC) can implement its capacity upgrades, direct recipients of the Options Price Reporting Authority (OPRA) data feed must have their data circuits upgraded and tested by the telecom vendors in order to accommodate the anticipated growth in capacity. The projected message growth brought upon by bifurcation of thousands of securities possibly occurring in September will require all upgrades to be completed and tested by August.
- Market data vendor upgrades to their users are still in the stages of planning and installation.
- Dividend adjustment processing of open orders by the firms would be complicated by the fact that some securities are trading in decimals and others are in fractions.

In summary, we believe that our ability to ascertain systems needs, the relatively short time frame, and the potential threat to investor confidence would make full decimalization for only the listed market by September 4 ill advised.

QUESTION #2

What, if any, systems changes or other steps would be necessary to implement Dual Pricing by this September 4, 2000 deadline? What type of changes would need to be made to the systems of securities firms, investment companies, and vendors? What would be the impact on systems capacity? In light of your answers to the foregoing questions, what changes would need to be made to the current decimals testing schedule?

ANSWER – Preliminary discussions with member parties involved in the decimal conversion planning process indicate that anticipated system changes would consist of (but not be limited to) the following:

- New file formats installed for all order processing systems at the markets, clearing corporations and vendors.
- The development of a method of distinguishing the thousands of securities trading in decimals versus those trading in fractions.
- Software enhancements to perform the necessary edits that have to be built to recognize which securities are trading in fractions vs. decimals by exchange.
- Upgrades to the infrastructure at firms, vendors and the clearing corporations must be in place and tested. There is a reliance on telecom vendors to provide T3 (high capacity) data circuits to these constituents.
- Order entry systems modified at the point of order origination to determine whether a security is trading in decimals or fractions. This would involve creating additional programming to reject or, if possible, convert mispriced orders.
- Trade adjustment input methods, display screens, online inquiries, confirms, statements, price history files, voice response technology, and market data feeds modified to recognize the dual pricing mode by security.
- Additional systems changes for ex-dividend processing, trade break reconciliation, margin calculations, risk analysis, portfolio management, and research analysis.
- Two complete sets of software to process both in decimals and fractions.
- Dividend adjustment processing of open orders.

The timing of many of the internal system changes mentioned above would depend in large measure on the timing of infrastructure upgrades by third parties such as telecom providers. Upgrades to server, telecommunication lines,

bandwidth, load balancing of data among message queues, and the analysis of the effect of the new traffic on overall system response time would have to be assessed.

In addition, a new study would be required to learn the impact of full bifurcation on systems capacity. SIA had commissioned SRI Consulting to conduct a study on the overall impact of decimals on the industry's message traffic. The study was conducted using a baseline of volume predicated on the history of message traffic and projecting out anticipated growth based on a nickel and penny minimum price variation. Since industry volume has grown to unprecedented levels over the last 18 months, the current SRI projection of an almost 300% increase in option quote traffic is conservative. SIA continues to work with the markets, clearing corporations, and SIAC to develop solutions for the message traffic capacity problems faced by the securities markets.

A new testing schedule could only be established following completion of a new industry-wide study. Because all related systems have to be re-configured and/or reproduced to deal with dual pricing, the integrity of existing assumptions and tests would prove irrelevant. Readiness could only be established with a new round of tests once all such system changes to accommodate dual pricing are complete.

As explained more fully below, a Decimals Pilot involving conversion of some listed securities to decimals would not significantly impact the original testing schedule, which envisions the completion of point-to-point testing by May 31, 2000 (excluding Nasdaq). Nasdaq's ability to handle some listed securities in decimals for third market makers should be an added element of the new testing schedule.

QUESTION # 3

Is the risk of customer confusion because of Dual Pricing significant, and if so, how should it be addressed?

ANSWER: Dual pricing involving thousands of securities trading in decimals at the same time that thousands of others trade in fractions would require a major educational effort. Educating customers about a Decimals Pilot, involving 30 or fewer securities would be far more manageable, which is one of the reasons why the original SIA plan would have launched conversion with a limited number of securities.

SIA's plan has always included a subcommittee dedicated to the communications aspect of decimal implementation. SIA plans to disseminate information about the conversion process to all member firms and the media both

through its website and using educational materials developed by the subcommittee. The educational component of the plan also envisioned the cooperation of the SEC and SRO's, which SIA expects will continue.

QUESTION # 4.

If commenters believe that implementing Dual Pricing by September 4, 2000 is not feasible, what date(s) is (are) feasible to implement Dual Pricing? Commenters should include a discussion of the systems changes and testing schedules that would be needed for their alternative implementation date(s).

ANSWER – For the reasons stated above, SIA does not believe that dual pricing is advisable at any time.

As previously stated, SIA supports the implementation of a Decimal Pilot for 30 or fewer listed securities, with Nasdaq securities to be added when that market is ready. This plan is manageable and should ensure a safe and orderly transition to decimal pricing while giving the industry sufficient time to access the message impact on the capacity infrastructure of the industry.

QUESTION # 5

In addition, if commenters believe that implementing Dual Pricing by September 4, 2000 is not feasible, is the alternative Decimals Pilot proposal feasible or preferable? If commenters believe that the Decimals Pilot is feasible, what, if any, systems changes or other steps would be necessary to facilitate this schedule? In particular, what changes would need to be made to the current decimals testing schedule? What type of changes would need to be made to the systems of securities firms, investment companies, and vendors? What would be the impact on systems capacity? Is there a risk of customer confusion, and if so, how should it be addressed?

ANSWER – The alternative Decimals Pilot is feasible and preferable. A Decimals Pilot would be functionally similar, in terms of allocation of resources, to that which was contemplated for Phase One of the original SIA plan, in which a small number of securities were to be converted to decimals. We support a Decimals Pilot that tracks the phase-in as originally planned and would be limited to approximately 30 securities. A limited pilot would also enable all parties to study the effects of decimals trading - including the impact on price efficiency, trading habits and capacity – and to take corrective action if deemed necessary.

There is a development effort with its associated costs that will be encountered regardless of whether we convert with 30 or 3,000 securities. However, over the life of the project, the resources necessary for full bifurcation under a dual pricing plan will be considerably greater than those which would be needed for a pilot.

The system changes that would be required for pilot program parallel to some degree those stated in the response to Question # 2 above. The major difference is that the effort required to operate a pilot program for fewer than 30 securities on an exception basis is significantly less arduous compared to the major system overhaul that would be required to handle a fully bifurcated environment. The same analysis applies in the context of systems capacity. With a pilot program, we will have adequate time to plan and take the proper action should the message traffic generated by decimals remain an issue.

With the exception of Nasdaq's ability to test Nasdaq securities, the schedule that was part of the original SIA plan has thus far not been modified and is proceeding on schedule. In contrast to full bifurcation, a Decimals Pilot would reduce the risk of overloading the industry's infrastructure since only a small group of securities are to be converted to decimals prior to full conversion.

We support a September 4th date for the commencement of a Decimals Pilot subject to the agreement of all parties, including the exchanges.

QUESTION # 6

If commenters believe that the Decimals Pilot is not feasible, what alternative would expedite the implementation of decimal pricing in exchange-listed and Nasdaq securities? Commenters should include a discussion of the systems changes and testing schedules that would be needed for their alternative, including implementation date(s).

ANSWER – SIA believes that a Decimals Pilot alternative is feasible.

QUESTION # 7

Commenters are requested to offer specific views on the optimal schedule for implementing decimal pricing in options based on exchange-listed and Nasdaq stocks subject to decimal pricing.

ANSWER - SIA recommends that options convert to decimals at the same time that the underlying security converts. In addition, SIA recommends keeping the price break point in a similar manner to what is in existence today. For option

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premiums quoted under \$3.00 a contract, that translates to a .05 MPV. For option premiums quoted at \$3.00 a contract or greater, we recommend a .10 MPV. More explicit specifications for converting options, with appropriate checkpoints, will be contained in a new Decimals Implementation Plan to be developed by the exchange committee.

CONCLUSION

Since the Nasdaq announcement, SIA, together with the firms, the exchanges, and other interested parties, has been actively pursuing alternatives to the original plan of September 10, 1999. Our efforts have led us to the strong conclusion that dual pricing is inadvisable if some decimal trading is to begin in the fall of 2000.

Based on final instructions from the SEC, we are ready to revise the implementation plan that is now underway to allow for a phased-in pilot program for limited trading in decimals by September 4, 2000 which will be expanded to accommodate some trading in Nasdaq securities in February, 2001. Assuming the evaluation of the pilot results reveals no problems, we expect to be able to facilitate a complete conversion to decimals on or about March 31, 2001.

We look forward to continuing to work with you, the Commission staff, the exchanges, the NASD, service bureaus, market data providers and telecommunications providers to ensure that the conversion to decimals occurs in both a timely and responsible fashion. If I can be of further assistance in answering any questions you or the staff may have, please contact me at 202-296-9410. Thank you for the opportunity to present the views of the SIA.

Very truly yours,

Marc Lackritz
President

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cc: The Honorable Arthur Levitt, Chairman
 The Honorable Norman S. Johnson, Commissioner
 The Honorable Isaac C. Hunt, Jr., Commissioner
 The Honorable Laura S. Unger, Commissioner
 The Honorable Paul R. Carey, Commissioner
 Annette Nazareth, Director, Division of Market Regulation, SEC
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