



Securities Industry Association

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October 16, 2000

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

Re: Limit Order Transparency Working Group

Dear Chairman Levitt:

At your urging, a Working Group of participants from the Securities Industry Association ("SIA")¹ and Investment Company Institute ("ICI") has been exploring issues surrounding increased transparency of limit orders in the U.S. equity markets.² While there is general agreement that information on priced orders beyond the inside best bid and offer is necessary and desirable, full transparency of limit orders by all market participants raises competitive and technological issues. Nevertheless, recent and anticipated market structure changes have highlighted the need for broader transparency and marketplaces have responded with proposals that will aggregate and display orders at multiple price levels. The Working Group carefully considered one such proposal—the

¹ The Securities Industry Association ("SIA") brings together the shared interests of nearly 800 securities firms, employing more than 380,000 individuals, to accomplish common goals. SIA members—including investment banks, broker-dealers, and mutual fund companies—are active in all 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, and accounts for \$270 billion of revenues in the U.S. economy. This and other recent comment letters can be found on the SIA's website at www.sia.com.

² SIA representatives on the Working Group were drawn from SIA's Market Structure Committee. The Market Structure Committee represents a diverse mix of SIA member firms and was formed to help develop positions on matters involving the market structure of the securities industry. The Committee's objectives are to encourage organizations, systems, policies and practices that best serve the long-term interests of investors, issuers, securities firms, and the public.

Nasdaq Stock Market's SuperMontage.³ Unfortunately, because of the way quotations of different market participants will be displayed in the system, not all Working Group members support SuperMontage at this time. SIA's Market Structure Committee ("Committee"), however, believes SuperMontage will significantly enhance transparency to the benefit of all market participants and should be approved without delay.

Nasdaq's SuperMontage proposal will offer NASD members the option of displaying limit orders at additional price levels away from the top of the book (*i.e.*, the inside quote) which is displayed today. The Committee believes that SuperMontage holds promise for significantly increasing transparency in the Nasdaq market in the near-term, although additional enhancements that will make more depth visible should be pursued going forward. We do not believe regulatory approval of SuperMontage should be deferred until agreement on necessary enhancements is reached. We urge the SEC to approve the SuperMontage proposal promptly as we continue to work with Nasdaq and other marketplaces to expand the display of limit orders, to facilitate more effective price discovery and stimulate price competition in our markets.

I. Background

On May 4, 2000, the SEC's Division of Market Regulation conducted a Roundtable on limit order transparency with retail, institutional, and wholesale firms, marketplaces, institutional investors, and market data vendors participating. Participants uniformly agreed that greater transparency was desirable but differed in their opinions as to how this should be achieved. During that meeting, as we had previously agreed, you announced that the SIA and ICI would form a group to resolve issues surrounding full limit order book display.

The Working Group, which is drawn from the SIA's Market Structure Committee and the ICI's Equity Markets Advisory Committee, met shortly thereafter and discussed at length the issues surrounding increased transparency. All agree that increasing transparency should add liquidity to the market to the benefit of all investors, particularly retail investors. Sell-side representatives, however, fear that increased transparency will create an unlevel playing field in which broker-dealers must display all limit orders, but institutions, because they generally do not place limit orders, will be the sole beneficiaries of the increased visibility. Buy-side representatives counter that there is no incentive to display their orders in the absence of price/time priority.

³ SR-NASD-99-53, Rel. No. 34-42166, 64 FR 68125 (Notice of Proposed Rule Change and Amendments No. 1 and 2); Rel. No. 34-42249, 64 FR 72712 (Notice of extension of comment period); Rel. No. 34-42573, 65 FR 16981 (Amendment No. 4); Rel. No. 34-43133, 65 FR 49842 (Amendment Nos. 5, 6, and 7); Rel. No. 34-43202, 65 FR 52803 (Notice of extension of comment period).

The Working Group agreed, however, that investors want and need more information on the depth of the market. Finer increments of trading have caused trading interest to be distributed across a greater number of price levels and the inside quote often is not an accurate indicator of the true market for a security. As a result of the SEC's Order Handling Rules, small orders at the inside quote can obscure trading interest at price increments one or two levels away, a situation that will be exacerbated in a decimal-trading environment. The clear consensus of the Working Group was that information on priced orders beyond the inside best bid and offer should be expanded.

II. SuperMontage Will Increase Transparency

There was less agreement among Working Group participants regarding how increased transparency should be achieved. For example, mandatory display of limit orders residing with market makers and wholesalers could present a technological challenge that would pale in comparison to the message traffic that is expected when the industry completes the transition to decimal trading.⁴ Therefore, the Working Group explored other options. SuperMontage appeared to be a viable alternative until strong opposition by electronic communications networks ("ECNs") that object to the placement of their orders in the SuperMontage caused several Working Group members to withdraw their support.⁵

The SIA Market Structure Committee believes additional visibility of market quote information can be achieved readily through the aggregation and voluntary display of limit orders at multiple price levels in a system such as the NASD's proposed SuperMontage. Moreover, while greater limit order visibility is important, the ability to access displayed orders is equally important. Nasdaq's SuperMontage will both increase transparency and will allow investors to access orders in the system. The Committee believes that SuperMontage is a good starting point for increasing transparency of limit orders across marketplaces. The SEC should approve this proposal promptly.

III. SuperMontage Should be Expanded to Additional Price Levels

As proposed, SuperMontage would display the best bid and offer in Nasdaq and two price levels away, accompanied by the aggregated size at each price level. Although this would enhance transparency to some extent, the Committee believes that the proposed number of price levels, particularly after the conversion to decimal pricing, will likely be insufficient. The SIA/ICI Working Group had met with senior Nasdaq officials to explore the feasibility of expanding the number of price increments displayed in

⁴ Due to volatility in the market, few of those limit orders are "resting." Rather, they are continually being canceled and replaced.

⁵ The NASD has announced Amendment Number 8 to SuperMontage, in an effort to address concerns of some market participants. We are hopeful that the refinements included in Amendment Number 8 will engender further support for SuperMontage.

SuperMontage. We understand that it would be possible to collect information on orders at numerous price levels and to incorporate that information into the SuperMontage if desired. In fact, once SuperMontage is approved, additional functionality could be added relatively quickly, perhaps before SuperMontage becomes operational.

The Committee believes SuperMontage presents the best opportunity for significantly enhancing transparency in the Nasdaq market in the near-term and we will continue to work with Nasdaq to determine the appropriate level of limit order display. It appears that display of limit orders at 100 increments higher and lower than the inside quote in a decimal trading environment would be possible, although capacity needs must first be assessed. The Committee is satisfied that the capability for significantly expanded display exists and, while hundreds of increments may be appropriate for very liquid, highly active stocks, for less active stocks, a percentage-based measurement might be more appropriate. Nasdaq officials have indicated their willingness to work with the industry to determine the appropriate levels of display and we do not believe approval of SuperMontage should be delayed while this issue is debated.

IV. Conclusion

Full limit order transparency by all market participants raises contentious issues and technological challenges. Although this may be feasible at some point, at the current time more modest opportunities exist to achieve greater transparency. The Committee firmly believes that SuperMontage is a step in the right direction. We urge the Commission to approve this proposal quickly so that we can assess the impact of greater transparency on the market. We note that the New York Stock Exchange ("NYSE") has announced plans to make specialists' limit order books visible to members and the public. We hope to meet with NYSE officials soon and look forward to working with them to achieve similar progress in the listed market.

If we can provide any further information or clarification of the points made in this letter, please contact the undersigned or Stuart Kaswell, SIA Senior Vice President and General Counsel, at 202-296-9410.

Sincerely,

Mark B. Sutton
Chairman
SIA Market Structure Committee

The Honorable Arthur Levitt

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CC: The Honorable Isaac C. Hunt, Jr., Commissioner
The Honorable Paul R. Carey, Commissioner
The Honorable Laura S. Unger, Commissioner
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