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Goldman Sachs

February 17, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Release No. 34-60997, File No. S7-27-09, Regulation of Non-Public Trading Interest

Dear Ms. Murphy:

Goldman, Sachs & Co. and Goldman Sachs Clearing & Execution, L.P., (collectively "Goldman Sachs") welcome the opportunity to provide the Securities and Exchange Commission (the "Commission") with comments on its proposed amendments to the regulatory requirements of the Securities Exchange Act of 1934 (the "Exchange Act") that apply to non-public trading interest in the U.S. equity market (the "Proposal").[1] We support the Commission's objective of improving the transparency, efficiency and quality of the U.S. equity market. The strength of U.S. equity market structure lies in providing all investors and other market participants with the necessary information, tools and flexibility to trade quickly and efficiently through the exercise of their own judgment, including by choosing between non-public (or "undisplayed") and displayed liquidity. Maintaining this strength is critical to ensuring that the U.S. equity market continues to perform in a fair, efficient and orderly fashion, as it is widely regarded as doing during recent years, despite historic levels of volatility.

Accordingly, we generally support the Proposal, and encourage the Commission to continue to provide interpretive guidance as market practices evolve and give rise to new types of orders and order placement mechanisms that may fall within the context and spirit of these new rules. We also recommend certain modifications to the Proposal that would help ensure the continued efficiency of the market and the flexibility of utilizing a variety of venues when accessing the markets, whether displayed or undisplayed. Specifically, in our view, the Commission should not adopt a rule that requires the identity of non-displaying, executing alternative trading system (ATS") to be reported on a real-time basis. Rather, such information should only be disclosed on a delayed basis or, if in real-time, on an aggregated basis across symbols in order to minimize the risk that the information is used to disadvantage investors who elect to use non-displaying ATSs, a result that could lead to decreased liquidity and higher

[1] Exchange Act Release No. 60997 (Nov. 13, 2009), 74 Fed. Reg. 61208 (Nov. 23, 2009) (the "Release").

execution costs. We believe that this approach helps preserve the benefits of non-displaying ATSs and strikes the appropriate balance of affording the investors who choose to trade on such venues reasonable anonymity while furthering the Commission's public policy goals of improved market transparency.

I. Actionable IOIs

U.S. equity market participants have benefited greatly over the years from a competitive price discovery process, operating under Commission regulation and oversight, that includes both displayed and undisplayed liquidity. As recognized in the Release, however, evolving technology and market practices have resulted in areas of "grey" liquidity whose status it would be desirable to clarify.

Accordingly, we support the Commission's proposal to amend the definition of "bid or offer" under Regulation NMS to include the concept of actionable indication of interests ("IOIs"). However, we are concerned that an express definition of actionable IOIs will not be sufficiently broad to encompass the evolving range of messaging and communications that, but for the absence of the name "IOI" or some other technical reason, might satisfy the definition of an actionable IOI. We appreciate the difficulty posed by the need to balance clarity with regard to the scope of conduct with the need to ensure that the definition is flexible enough to fulfill the broader policy objectives. Therefore, we urge the Commission to consider the range of facts and circumstances that might give rise to actionable IOIs by reviewing the practices surrounding other trading tools, such as order routers, to identify communications that, other than in name, are the equivalent of actionable IOIs. At the same time, in our view it is critical that the Commission preserve the function of traditional, non-actionable IOIs, which importantly provide a means for market participants to communicate trading interest still subject to negotiation.

We also concur with the Commission that it is appropriate to include an exception for certain large size actionable IOIs. As the Commission notes, such an exception is necessary to permit block crossing networks and other trading venues to offer new ways for investors that need to trade in large size to find contra-side trading interest without affecting prices.[2] We recommend, however, that the Commission use this opportunity to more broadly consider the criterion for block sized orders and adopt a definition that is more suited to the current market structure. In today's market structure, order handling practices vary depending upon the trading characteristics of a particular security (*e.g.*, large cap vs. small cap, actively-traded vs. non-actively traded) and the method elected to source liquidity (e.g., a negotiated block versus a block that is apportioned into smaller quantities and fed into the market through use of an algorithmic or other automated program). Our suggested approach for such a standard would be to vary the parameters for block size by dividing stocks into different tiers based on market capitalization, which in our view would take into account the trade-ability of a security in a simple, readily implemented fashion. We believe that the Proposal provides the Commission with an ideal opportunity to reevaluate the current definitions and provide updated guidance for a

[2] Release at 61212.

more uniform approach to blocks to be applied more across the context of the Exchange Act and rules thereunder.[3]

II. ATS Display Obligations

We support the proposed reduction in the threshold for triggering display obligations of ATSs, which is needed to better integrate the trading interest of more market participants into the overall market, particularly in light of the proposed inclusion of actionable IOIs within the amended definition of "bid or offer." We recommend, however, that the Commission adopt a 1% threshold consistent with the threshold applicable to exchanges and OTC market makers under Regulation NMS,[4] in order to ensure a level playing field between ATSs and other trading venues and to limit incentives for regulatory arbitrage.

Additionally, because the Proposal would extend display obligations to many venues and orders not previously integrated into the consolidated public quotation stream, we urge the Commission to provide market participants with ample time and guidance to allow proper implementation of the Proposal, from both business and operational perspectives. For example, many exchanges and broker-dealers operate "smart routers" that send actionable IOIs, and we urge the Commission to consider how display obligations should be applied to that practice. Similarly, it is not clear whether or how certain order functionalities currently in widespread use, such as floating price orders (*e.g.*, mid-point pegged orders) and conditional orders (*e.g.*, minimum size orders), can function properly if displayed. At the same time, new exceptions for these types of order functionalities could create loopholes, which the Commission should seek to avoid.

III. Post-Trade Transparency for ATSs

We support the Commission's proposals to increase post-trade transparency so that market participants and regulators receive reliable statistics about trading volume. However, in our view, it is imperative that these goals be achieved while minimizing the potential negative impact on liquidity and execution costs. The distinctive features of ATSs increase their vulnerability to opportunistic trading. For example, the order matching logic of many ATSs is keyed off of the NBBO, *i.e.*, midpoint crosses. This general knowledge, combined with information that identifies individual ATSs on trade reports in the public data stream, would significantly increase the likelihood that block orders could be detected, thus, exposing them to opportunistic trading and undermining the value of anonymity afforded in non-displaying ATSs. In order to address these concerns, we suggest that, rather than requiring non-displaying ATSs to disclose their identifiers on their real-time trade reports, the Commission require disclosure on a

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[3] In addition to Regulation NMS and, under the Proposal, Regulation ATS, we note that the term "block" is also used in Rule 3b-8 (definition of "block positioner"), Rule 10b-18 (safe harbor from liability for manipulation for certain issuer repurchases), Rule 15g-6 (exception from "qualifying purchases" definition for purposes of calculating market value of penny stocks in account statements), Rule 16a-7 (exemption from disclosure requirements under Section 16(a)) and Rule 16c-2 (exemption from liability under Section 16(c)).

[4] See Rule 600 of Regulation NMS (definition of "subject security").

delayed basis (i.e., T+3) per security or, alternatively, on a near real-time (*e.g.*, 5 minutes) basis aggregated across all symbols.

We suggest that the Commission consider this modified approach for non-displaying ATSs because it will help preserve the benefits of anonymity that are the hallmark of these market venues. For ATSs subject to display obligations, on the other hand, we agree with the Commission that identifying information should be disclosed in the real-time trade reports. In this regard, in our view, there are significant, functional distinctions between non-displaying ATSs, which provide investors and market participants with the means to source liquidity without excessive market impact, and displayed ATSs, which in many respects are the functional equivalents of exchanges. We further believe that displaying ATSs should make this disclosure with respect to all trades, whether in block or non-block size, consistent with the trade reporting obligations applicable to exchanges.[5] By adopting these modifications the Commission will further the goals of transparency by requiring ATSs to report all trading volume, rather than some fraction of volume comprised of only smaller size trades. A rule that does not require the marketplace to fully identify the proper total aggregate volume taking place in all trading venues would be sub-optimal and fail to achieve the goal of improved transparency.

IV. Preserving the Benefits of Both Displayed and Undisplayed Liquidity

More broadly, we consider it important to underscore that the mere existence of undisplayed liquidity should not be viewed as inherently disadvantaging displayed liquidity. As the Release states, undisplayed liquidity "is not a new phenomenon," and floor traders, OTC market makers, and block positioners have for many years served as sources of undisplayed liquidity.[6] The emergence of so-called "dark pools" as a significant source of liquidity has not been at the expense of displayed liquidity, as the relative proportion of displayed versus undisplayed trading volume has remained mostly stable for the last few decades, even amidst numerous changes to market structure and dramatic shifts in market conditions.[7] Rather, the emergence of dark pools reflects an overall evolution and expansion in trading venues supported by several developments over the last several years, including Regulation ATS, decimalization, Regulation NMS, demutualization and technology advancements, all of which have lowered barriers to entry and fostered innovation and competition.

Indeed, there has always been ebb and flow between displayed and undisplayed liquidity, as investors and other market participants seek out best execution. Displayed liquidity has traditionally had the advantages of establishing a reference price and increasing certainty of execution by attracting contra-side trading interest. Recent regulatory and market structure changes have added further advantages to displayed liquidity, including trade through protection

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[5] We note that identity of a trading venue should not be disclosed through use of a separate MPID, which has certain system requirements that are specific to audit trails and clearing. Rather, any mechanism separately identifying the venue would suffice.

[6] Release at 61208-09.

[7] Trade Reporting Facility volumes have hovered around the 20% range (adjusted for transitional players) for the last few decades. See also Concept Release on Equity Market Structure, Exchange Act Release No. 61538 (Jan. 14, 2010), 75 Fed. Reg. 3594, 3613 (noting that the overall percentage of trading volume between undisplayed and displayed trading venues has remained fairly steady for many years between 70% and 80%).

and quote credits/rebates. Undisplayed liquidity, on the other hand, has the advantages of reducing market impact and increasing the potential for size improvement. These advantages apply not only to large size orders, but also small size orders for less liquid securities and small orders that are part of a trading strategy involving execution of a larger "parent" order over time. Investors and other market participants have long exercised their judgment in balancing these different advantages, shifting their level of interaction with the market from more passive (undisplayed) to aggressive (displayed) and vice versa as market conditions change.

Undisplayed liquidity should also not be viewed as detracting from the price discovery process. Price discovery does not occur only through displayed quotations, but also through last sale reporting, non-actionable IOIs and other mechanisms that provide information about supply and demand. Investors and other market participants use all of these mechanisms to determine the prices at which to buy and sell, and so in our view the value of undisplayed liquidity can only be evaluated accurately by taking all of these mechanisms into consideration. Viewed from this broader perspective, it is clear that displayed and undisplayed liquidity each make important contributions to price discovery.

Accordingly, we consider it essential to preserve the flexibility for investors and market participants to choose between displayed and undisplayed liquidity. In contrast, attempting to increase displayed liquidity by imposing "trade at" protection would decrease the choices available to investors and other market participants, remove any incentive for trading venues to reduce quote access fees, increase the costs of trading and introduce additional latency and fill uncertainty. Moreover, trade at protection would raise, over time, many of the potential concerns associated with a central limit order book, which the Commission previously sought to avoid during the Regulation NMS rulemaking process.

V. Conclusion

For the reasons set out above, we support the Commission's effort to address the issues raised in the Release, and recommend that the Commission:

- As proposed, modify the definition of "bid or offer" to clarify display obligations for actionable IOIs, with an exception for large size orders;

- Lower the threshold for ATSs' display obligations to 1%, consistent with the threshold applicable to exchanges and OTC market makers; and

- Modify the proposed post-trade transparency requirements for non-displaying ATSs to require either (a) near real-time (*e.g.*, 5 minutes) disclosure of trade volume aggregated across all symbols or (b) per-security disclosure on a delayed, T+3 basis. For displaying ATSs, require real-time disclosure on a trade-by-trade basis. No large size trade exception is necessary.

These amendments would, in our view, go a long way to achieving the Commission's goal of addressing the potential for a "two tiered" market, while also ensuring that the market continues to operate efficiently and without unduly burdening *bona fide* undisplayed liquidity. In this way, investors and other market participants would be able to force the right balance in the marketplace between undisplayed and displayed liquidity through the exercise of their own judgment and best execution responsibilities.

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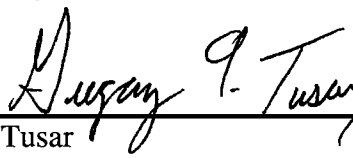
Goldman Sachs appreciates the opportunity to comment on the Proposal and looks forward to working with the Commission on these issues. We would be pleased to discuss any of the comments or recommendations in this letter with the Commission staff in more detail. Please feel free to contact the undersigned with any questions.

Sincerely,



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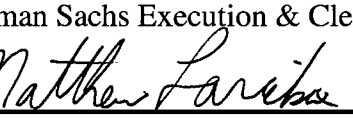

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