CFA INSTITUTE | Centre for Financial Market Integrity

19 January 2006

Ms. Lori Richards
Director
Office of Compliance Inspections and Examinations
U.S. Securities and Exchange Commission
Securities and Exchange Commission
100 F Street, NE
Washington DC 20549

Re: Potential Market Abuse

Via email to: richardsl@sec.gov

Dear Ms. Richards,

The Capital Markets Policy Council (the "Council") of the CFA Centre for Financial Market Integrity ("CFA Centre" or the "Centre")[1] would like to call to your attention a number of concerns that it and other CFA Institute members have raised about possible trading abuses. The Council, comprising 12 investment professionals from throughout the world and serving as volunteers on behalf of the Centre, wish to present these concerns to you and others at the Securities and Exchange Commission (the "SEC" or the "Commission") to encourage that steps be taken to prevent the kinds of abuses described below.

First among these concerns is the consolidation of ownership of regulated exchanges. While the Council believes that central securities marketplaces are important for price discovery, consolidation of the ownership of regulated exchanges could concentrate ownership among a few owners, including a limited number of investment firms (the "Firms").

Such concentration causes unease because these Firms also are some of the most active participants in these markets, and consolidation could allow them to access order flow and other trading information which they could use to the detriment of certain clients, competitors and investors. In response, the Council urges the Commission to actively enforce existing regulations against front-running and manipulation of prices to ensure that these Firms do not engage in this type of market abuse.

A second concern voiced by CFA Institute members in a December survey is that brokerage houses do not currently have adequate safeguards in place to prevent their proprietary trading

[1] The CFA Centre for Financial Market Integrity is a part of CFA Institute. With headquarters in Charlottesville, Virginia, USA, and regional offices in London, Hong Kong, and New York, CFA Institute, is a global, non-profit professional association of more than 79,000 financial analysts, portfolio managers, and other investment professionals in 125 countries and territories of which more than 64,000 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 131 Member Societies and Chapters in 53 countries and territories.

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desks from taking advantage of orders received from clients by their agency trading desks. Of the 1,096 CFA Institute members responding, 87% said brokerages do not have adequate safeguards, with 54% urging action to prevent abuse and the remaining 33% saying it was “a fact of life” that investors must accept. Just 13% felt brokerages had sufficient safeguards to prevent this type of market abuse. The survey’s respondents came primarily from the investing side of the business — 79% — with the remaining 21% from the brokerage side.

To remedy this potential abuse, the Council suggests that the Commission take steps to ensure that firms be required to (1) physically separate proprietary desks from agency trading desks, and also (2) to implement effective safeguards to prevent information transfers between the two trading desks. This separation would amount to something akin to the degree of separation now required between investment banking and investment research. While this suggestion may not prevent all such abuses, it will make it more difficult for traders to freely communicate without creating a trail of evidence.

Finally, council members are concerned that program trading platforms might be subject to trading abuse, as well. In part this is because the same Firms acquiring control of order flow also provide much of the software that institutional investors use to engage in such trading. Under these types of arrangements, there is an opportunity for the Firms providing the software to engage in “reverse engineering” — using knowledge about the program trading techniques of a particular program to determine the order flow of an investor using that program — thereby impairing investors’ ability to trade anonymously.

The Council encourages the SEC to consider the issues raised in this letter and to investigate where appropriate.

If you or your staff have questions or seek amplification of our views, please feel free to contact James C. Allen, CFA, by phone at +1.434.951.5558 or by e-mail at james.allen@cfainstitute.org.

Sincerely,

/s/ Frederic P. Lebel	*/s/ James C. Allen*
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