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ON

“REGULATION NMS AND DEVELOPMENTS IN MARKET STRUCTURE”

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

U.S. SENATE

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I. Introduction

My name is Kevin Cronin. I am Senior Vice President and Director of Equity Trading at AIM Investments in Houston, Texas. AIM Investments was founded in 1976 and had $148 billion in assets under management and approximately 11 million shareholders as of March 31, 2004. I would like to thank the Committee for providing me with the opportunity to testify on the SEC's Regulation NMS proposal and developments in the structure of the U.S. securities markets. While I am speaking today on behalf of AIM Investments, I am also expressing the views of the Investment Company Institute, the national association of the American investment company industry. I am a member of the Institute's Equity Markets Advisory Committee, which consists of approximately eighty senior traders at various large and small mutual fund firms. The Institute submitted a comment letter on the Regulation NMS proposal, which was the product of much discussion among Equity Markets Advisory Committee members and which expresses a consensus view of those members. I also currently serve as Chairman of the New York Stock Exchange's Institutional Traders Advisory Committee, which provides comment and recommendations to the Exchange on methods to improve its trading systems.

Although Regulation NMS consists of four substantive proposals addressing a wide variety of issues impacting the structure of the U.S. securities markets, I will focus my comments on Regulation NMS' trade-through proposal, which arguably could have the most impact on the structure of the securities markets going forward. Before I discuss some of the specific issues relating to the trade-through proposal, however, I would like to discuss why the issues raised by Regulation NMS and the debate over market structure is important to investors and, in particular, the mutual fund industry. Increased efficiencies in the markets will significantly benefit mutual fund shareholders in the form of lower costs. Mutual funds, therefore, have a vested interest in ensuring that the securities markets are highly competitive, transparent and efficient, and that the regulatory structure that governs the securities markets encourages, rather than impedes, liquidity, transparency, and price discovery.

How do we create the optimal market structure for investors? We believe the SEC must focus its efforts on the principles of a national market system that Congress itself found appropriate over thirty years ago for the protection of investors and the maintenance of a fair and orderly market - efficiency, competition, price transparency, and the direct interaction of investor orders. As the SEC noted in the Regulation NMS proposing release, possibly the most serious weakness of the national market system is the relative inability of all investor buying and selling interest in a particular security to interact directly in a highly efficient manner. This weakness, in turn, creates a disincentive to investors to publicly display their limit orders, which are the cornerstone of efficient, liquid markets and, as such, should be afforded as much protection as possible.

In order to provide investors with the incentive to publicly display their orders and to create a market structure in which these orders can effectively interact, several changes must be made to the structure of the securities markets. Most significantly, price and time priority should be provided for displayed limit orders across all markets; strong linkages between markets should be created that make limit orders easily accessible to investors; and standards relating to the execution of orders should be created that provide the opportunity for fast, automated executions at the best available prices.

It is important to note that problems surrounding the lack of order interaction, its causes, and its impact on the securities markets are not new. Mutual funds have, for many years, recommended changes to the structure of the securities markets to facilitate greater order interaction and, in turn, more efficient trading. While much has been made about how various industry participants may or may not have aligned themselves with various competing market centers in the market structure debate, I want to make one point clear. AIM's and ICI's sole interest in this discussion is in ensuring that proposed market structure changes promote competition, efficiency and transparency for the benefit of all market participants and not for a particular market center or exchange. Market centers should compete on the basis of innovation, differentiation of services and ultimately on the value their paradigm of trading presents to investors.

II. Trade-Through Proposal

Although Regulation NMS and the trade-through proposal would not implement all of the components we believe necessary for investors' orders to fully interact in an efficient manner, a uniform trade-through rule would be a significant step forward in providing protection for limit orders and, by affirming the principle of price priority, should encourage the display of limit orders. We believe, if appropriately instituted and enforced, a uniform trade-through rule also would increase investor confidence in the securities markets by helping to prevent an investor's order executing at a price worse than the displayed quote. We therefore support the establishment of such a rule.

In order for a trade-through rule to fully achieve its objectives, it is extremely important that only "automated" quotes, *i.e.*, quotes that can be executed against automatically and promptly without *any* manual intervention, be protected and that markets provide prompt automatic updates of those quotes. It is for this reason that we support an exception to the trade-through rule that would permit an automated market to trade through a manual market for an unlimited amount or, as has been discussed recently by the SEC, an automated quote to trade through a manual quote for an unlimited amount. Such an exception would correctly focus the trade-through rule on providing protection only to those quotes that are truly firm and immediately accessible and not quotes that require manual execution and are, in effect, only "maybe" quotes or difficult or slow to access. We also support the creation of strong standards to accompany such an exception, which would delineate when an "automated" quote would be permitted to move into a manual execution mode and then back again to an automatic execution mode. We believe an exchange should only be permitted to "turn off" the automation feature of its quote, if at all, in extremely limited circumstances and only in critical situations.

While most trading venues provide the opportunity for true automatic execution, certain exchanges still do not offer such a choice for institutional investors. The New York Stock Exchange has stated recently that they intend to provide automatic execution to at least the best bid and offer on the Exchange and has been discussing plans to transform their market into a "hybrid" market. It is important, however, that any automation on the NYSE not be wrought with exceptions that would, in effect, make claims of automation folly. Too often, institutions have heard plans to automate NYSE trading systems only to find out, after examining details of those plans, that they did not go nearly far enough towards implementing the necessary automation on the Exchange. We therefore urge the NYSE to move expeditiously to implement true automation in its market that would provide investors with much needed automatic execution of their orders. Such changes should be implemented regardless of whether the SEC's Regulation NMS proposal is adopted. One thing, however, is certain. Until the NYSE provides true automatic execution on its market, manual quotes on the New York Stock Exchange should not receive the protections of any trade-through rule adopted by the SEC.

The proposed trade-through rule also contains another exception, the "opt-out" exception, which would permit a person for whose account an order is entered to opt-out of the protections of the trade-through rule by providing informed consent to the execution of their orders in one market without regard to the possibility of obtaining a better price in another market. We oppose the opt-out exception. In principle, the SEC's proposal to allow an exception to the trade-through rule in the form of an opt-out seems antithetical to the proposition of providing greater protection for limit orders. Institutions and other informed investors opting-out would undermine the display of liquidity, which would likely result in less efficient markets. Therefore, we believe that protecting the integrity of the trade-through rule outweighs any flexibility an opt-out provision would provide. While there is no doubt that, at times, investors may determine that speed and/or certainty is more important than price in executing an order, and while investors may be best served on a particular trade by opting out from executing against the best price placed in another market, we believe that in the long term, *all* investors will benefit by having a market structure where *all* limit orders are protected and investors are provided with an incentive to place those orders into the markets. We are therefore dubious of any regulation that would tacitly approve the pursuit of "inferior" prices to the detriment of those who are willing to display best prices.

While there is clearly no consensus among market participants, and even among some institutional investors, on whether an opt-out exception is necessary, there does seem to be agreement that if the SEC does not restrict trade-through protection to only automated markets or automated quotes, and does not create a strong definition of what would be considered “automated,” some sort of flexibility should be provided to investors to permit them to trade through markets that cannot provide the highest order of certainty and speed. In such a case, we believe a block trade exception to the trade-through rule may be necessary in order for institutional investors to efficiently trade large amounts of stocks. In any case, we believe that a block trade exception would be preferable to an opt-out exception to facilitate these types of transactions. Most significantly, a block trade exception would be more limited in nature than an opt-out exception and would be more feasible to employ.

III. Market Linkages

It is important that another key aspect of improving the structure of the U.S. securities markets be considered in the debate over the proposed trade-through rule. In particular, we believe that in order for a uniform trade-through rule to operate effectively, strong linkages and minimum access standards must first be put into place. Otherwise, we are concerned that it will be an exercise in futility to require that a market send an order to another market to execute against a better priced order on that market if that better priced order cannot be accessed easily and with certainty. We therefore believe that prior to implementing the proposed trade-through rule, the SEC should ensure that effective linkages and minimum access standards between markets are in place to support such a rule.

IV. Conclusion

It is noteworthy that the SEC reaffirms, through statements in Regulation NMS, that its role is to facilitate the development of the national market system and not dictate its form. We believe that competition should largely define the structure of the capital markets. In the end, such competition will promote innovation and differentiation, which will benefit shareholders of all sizes. Also, it will ensure that the U.S. capital markets retain their rightful place as the most liquid, transparent and efficient markets in the world.

Thank you again for providing me with the opportunity to share my thoughts on Regulation NMS and the trade-through proposal. I would be happy to answer any questions that you may have.