



**DEPARTMENT OF JUSTICE**  
Antitrust Division

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September 23, 1999

Stuart J. Kaswell, Esq.  
Senior Vice President and  
General Counsel  
Securities Industry Association  
1401 Eye Street, N.W.  
Washington, D.C. 20005-2225

Dear Mr. Kaswell:

This letter responds to your request on behalf of the Securities Industry Association ("SIA") for the issuance of a business review letter pursuant to the Department of Justice's business review procedure, 28 C.F.R. § 50.6. You have requested a statement of the Department's current antitrust enforcement intentions with respect to a proposed information exchange program designed to resolve equity securities and options trading systems capacity and operational issues posed by the conversion of those systems from a fraction-based to a decimal-based format.

The current pricing system used in trading equity securities and options in the United States uses fractions, e.g., 1/2, 1/4, 1/8, 1/16, as minimum price variations. The rest of the world's major trading markets are decimal-based. The advent of computerized trading systems has made it more feasible to convert from a fraction-based to a decimal-based system. Critics of the fraction-based system currently used in the United States assert that it results in wider spreads on margins for dealers and market makers at the expense of consumers of trading services, i.e., investors.

The SIA is an association of nearly 800 securities firms.

SIA members -- including investment banks, brokers-dealers, and mutual fund companies -- are active in all markets and in all phases of corporate and public finance. In the U.S., SIA members collectively account for approximately 90 percent, or \$100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans.

SIA has developed a comprehensive program to change the trading increments for equity securities and equity stock options from fractions to a decimal-based system based on either 5 cent or 1 cent increments (e.g., 20 or 100 price points within each dollar). The industry's target date for completing the conversion is June of 2000. To be successful, the conversion project will require extensive sharing of information among securities market participants, including broker-dealers, exchanges, clearing entities, data processors, depositories and market data vendors.

SIA has agreed to oversee and manage the effort to implement and coordinate the conversion to decimal trading. Such coordination will entail the development of a comprehensive plan to establish interim milestones for testing and implementation of the decimalization conversion, as well as delineating the technical standards and specifications needed to preserve the efficient working of the various affected markets. To develop and execute this plan, SIA and participating entities need to exchange information with each other on the potential effects of the conversion on all aspects of market operations, including information processing and communications capacity, as well as market and exchange rules.

SIA has taken three steps thus far to commence its work on conversion to a decimal-based equity trading system. It has appointed a Decimalization Committee to lead the initiative. It also has commissioned a recently completed study by an outside consultant assessing the impact of decimal trading on various message volume under both a nickel (\$0.05) and a penny (\$0.01) minimum price variation ("MPV"). Finally, it has sent out a survey to broker-dealers, exchanges, financial utilities, and market data vendors, to try to determine from them their state of readiness for

decimalization, and specific systems issues that they need to address to successfully convert to decimals. The result of the survey, together with the work of the SIA Decimalization Committee, and the Testing and Implementation Subcommittees, will be used to develop a detailed time table for the implementation of decimal-based trading.

SIA asserts that it has been working closely with the SEC on the project; inviting SEC staff to participate in key meetings of the Committee, copying SEC staff on all material written communications, and regularly briefing the SEC staff on the status of the project and on all significant developments. The proposed information exchange program will allow SIA to compile information regarding issues relevant to conversion to decimal-based trading. Thereafter, SIA hopes to develop recommendations for conversion to decimal-based trading, many or most of which will be published for public notice and comment by the SEC, either as rule proposals by one or more self-regulatory organizations subject to SEC approval, or as the SEC's own rule proposals.

SIA intends to exchange information regarding the following issues:

- C The feasibility and practicality of developing sufficient capacity to handle a particular MPV for each exchange, such that the MPV is compatible with the ability of the computer systems to handle increased message traffic;
- C Managing increases in quotation message traffic on trading systems because of: (i) increases in potential price breakpoints and (ii) reduced bid-ask spreads.
- C Implementation and testing scenarios, including whether a phase-in or a cut-over approach is the best way to implement decimalization (this might include the development of a pilot program and related testing schedule);
- C Identifying functions to test in areas such as exchange interfaces, order routing and processing systems, buy-side interfaces, order submission, inventory systems, automatic executing systems, submission of information into trade comparison, portfolio systems, institutional

delivery and affirmation, risk management, compliance, margin, and bookkeeping systems, correction processing, vendor interfaces and securities pricing systems;

- C Considering new approaches to managing expected massive increases in message traffic, such as exploring new ways to process quotations; and
  
- C Designing methods of stress-testing the infrastructure to ensure that the projected message volumes will not cause systems to queue up or fail because of heavy volume. SIA notes that the development and testing of a program for the decimalization of options trading will be a particularly important part of the overall decimalization effort. In contrast to equity securities, the overwhelming amount of options message traffic consists of quote messages rather than trade reports. A reduction in quotation increments offers greater variation in quotes (e.g., the mechanical effect of changing the tick size from 1/16 to \$0.05 produces 25 percent more potential price levels). Since quotation messages dominate options message traffic, there is expected to be a particularly significant increase in options message volume. A study commissioned for SIA projects that a nickel MPV would result in message traffic for options increasing by more than 50 percent, while a penny MPV would boost message traffic volume by over 250 percent. The SIA will survey the impact of such dramatic volume increases and disseminate and discuss the results as part of its proposed information exchange.

Company or exchange specific information will flow from each individual entity to the SIA staff or its independent consultant. Only aggregate information, including survey results and industry-wide proposals based on those results, would be shared among SIA members and others that are part of the decimalization conversion project, including regulators, broker-dealers, exchanges, depositories, utilities, and clearance and settlement entities. No company-specific information about prices, capacity, or future plans will be exchanged directly among SIA members or other participants in the project. No discussion will take place about specific prices of any security or option. There may be a need for

some general discussion of systems issues posed by trading in nickel or penny increments, but if any competitively-sensitive information is exchanged, it will be distributed in aggregate format by the SIA, concealing the identity of specific providers. Neither the participants nor SIA intend to recommend in favor of, or against, the products or systems of particular vendors. The information exchanged will be stated in non-judgmental terms so that there can be no legitimate inference that the sharing of information will result in any anticompetitive consequences (*i.e.*, group boycott activity). It will be for SIA members to decide, as individual entities, how, or even whether, each will use the information disseminated. Legal counsel will participate in all meetings, and SEC staff are expected to attend frequently.

Based on the information and assurances provided to us by the SIA, and the nature of the proposed information exchanges, the Department does not believe that the proposed exchanges will have anticompetitive effects. There will be no transaction-specific price, cost or marketing information exchanged among rivals. Rather, the information will be general in nature and related to capacity and other operational characteristics of the communications systems or processes that will be the infrastructure on which equity securities and options trading will be based. No competitively sensitive information will be exchanged between rivals. To the extent that the compilation of any such information is necessary to facilitate the conversion to a decimal-based system, it will be communicated to SIA personnel who will only distribute it in aggregated form that masks firm-specific information. No collective purchasing decisions will be made on the basis of any studies compiled from the information to be exchanged. We understand that the proposed information exchanges will be limited to exchanges necessary to effectuate the SIA's decimalization project. Under such circumstances, the proposed information exchanges would not appear to raise any significant risks to competition.

Finally, we note that it is possible that the information exchanges will have procompetitive effects depending upon the nature of the recommendations that emerge from the process.

This letter express the Department's current enforcement intentions, and is predicated on the accuracy of the

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information and assertions that you have presented to us. In accordance with its normal practice, the Department reserves the right to bring an enforcement action in the future if the actual activities of the SIA or its members prove to be anticompetitive in any purpose or effect.

This statement is made in accordance with the Department's business review procedure, 28 C.F.R. § 50.6. Pursuant to its terms, your business review request and this letter will be made publicly available immediately, and any supporting data will be

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made publicly available within thirty days of the date of this letter, unless you request that any part of the material be withheld in accordance with Paragraph 10(c) of the business review procedure.

Sincerely,

Joel I. Klein