August 16, 2011

BY ELECTRONIC MAIL

Mr. Werner Bijkerk
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Re: Public Comment on Consultation Report: Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency

Dear Mr. Bijkerk:

The Securities Industry and Financial Markets Association ("SIFMA")[1] welcomes the opportunity to comment on the Consultation Report regarding Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency of the Technical Committee (the "Committee") of the International Organization of Securities Commissions ("IOSCO").[2] We appreciate the timeliness of the Committee's review of issues raised by the impact of technological changes on market integrity and efficiency, and are pleased to comment on the 14 questions set forth in the Report. In this regard, in response to various market structure rule proposals and concept releases published by the U.S. Securities and Exchange Commission (the "SEC"), SIFMA has commented on many of the same, or similar, issues, and has included copies of those letters for your reference.[3]

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[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, DC, is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

[2] Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency, Consultation Report, Technical Committee of the IOSCO (July 2011) (the "Report"), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD354.pdf.

[3] In particular, in response to requests for comment by the SEC, SIFMA has commented on a number of issues that address the 14 questions set forth in the Report. *See* Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (Apr. 16, 2010) (SIFMA's comments on the SEC's proposal to adopt a rule requiring risk management tools for broker-dealers with market access);

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Technology has led to dramatic improvements in information processing and communications and facilitated the development of new trading strategies, such as high frequency trading ("HFT"). We believe that these and other changes that have occurred in the markets cannot be universally characterized as favorable or unfavorable market developments. Rather, these technological developments are complex in nature. On the one hand, they represent certain advancements for investors and the markets. Yet, on the other hand, for regulators, these developments may present issues in terms of achieving certain stated goals. Hence, the challenge is to recognize and realize the benefits offered by these developments while working carefully to address any associated, valid regulatory concerns.

The Report also notes that IOSCO has been examining the role of HFT in the markets. In this regard, when considering the various practices and tools often utilized in HFT, it is important to keep in mind that HFT is a type of trading, not a type of trader. Not all market participants engage in HFT, and not all market participants that are generally categorized as "high frequency traders" actually employ HFT strategies. Therefore, in order to achieve the objectives of the regulatory initiatives without unintended consequences, any regulatory initiatives designed to address HFT should be targeted to the type of activity, rather than to the type of market participant. SIFMA also believes that HFT provides significant liquidity to all investors, including long-term investors. It is estimated that HFT accounts for 50% or more of the volume in the U.S. equity markets.[4] Hence, to the extent that HFT orders establish or supplement the national best bid and offer (the "NBBO"), they not only facilitate the trading objectives of HFT traders, but also serve as a reference point for executions by other market participants. In addition, SIFMA believes that certain strategies associated with HFT that involve arbitrage of related financial instruments may help keep prices in line by identifying and capitalizing on disparities between such instruments in different markets.

Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (Apr. 29, 2010) (SIFMA's comments on the SEC's concept release on the market structure of the U.S. securities market) ("SIFMA Comments on Equity Market Structure Concept Release");
Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (June 25, 2010) (SIFMA's comments on issues raised during the SEC's Market Structure Roundtable); Letter from James T. McHale, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (Aug. 17, 2010) (SIFMA's comments on the SEC's proposal to established a consolidated audit trail") ("SIFMA Comments on Consolidated Audit Trail"); Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (Mar. 21, 2011) (SIFMA's comments on the recommendations of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues); Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (June 22, 2011) (SIFMA's comments on the limit-up/limit-down proposal by various self-regulatory organizations ("SROs")) ("SIFMA Comments on the Plan"). Copies of each letter are attached as Exhibits A through F, respectively.

[4] *See* Concept Release on Equity Market Structure, Securities Exchange Act of 1934 (the "Exchange Act") Rel. No. 61358 (Jan. 14, 2010), 75 Fed. Reg. 3594, 3606 (Jan. 21, 2010) (citing Jonathan Spicer and Herbert Lash, Who's Afraid of High-Frequency Trading?, Reuters.com, December 2, 2009 (available at http://www.reuters.com/article/idUSN173583920091202)).

However, as HFT has increased, issues have arisen regarding the fairness of HFT and whether such trading imposes an unreasonable amount of systemic risk on the equity markets. As discussed below, SIFMA believes there is a need for more disclosure about HFT and related issues.[5] Such disclosure not only would provide market participants with more information related to important market practices, but also would facilitate the efforts of regulators to appropriately regulate the markets. Similarly, we support the enhancement of risk controls related to market access, including HFT.

Our views on these and other issues are further described below in response to the questions asked in the Report.

I. Specific Questions

A. Question 1: What impact have the technological developments in the markets in recent years had on your own trading? Has it encouraged, discouraged or had no impact on your willingness to participate on the lit markets, and how does this differ between asset classes and/or instruments?

As described in our comments on the Committee's report on issues raised by dark liquidity,[6] we believe that technological developments have led to a number of benefits to the market. As a general matter, these benefits to the market have increased the willingness of SIFMA members to participate in the market. Notwithstanding general benefits to the market, certain changes have increased the challenges associated with executing orders, and large orders in particular. For example, decimalization of the U.S. markets narrowed spreads, but also has resulted in reduced size of displayed quotations, making it more difficult to execute larger orders. This, in turn, has led to the increased use of algorithms to handle large orders and the need for undisplayed liquidity pools. SIFMA believes that U.S. markets remain healthy, in part because of the availability of undisplayed liquidity. For example, a recent working paper on the impact of dark pools on U.S. market quality concludes that "a higher amount of dark pool activity is associated with lower quoted and effective spreads, lower price impacts, and lower short-term volatility. In other words, more dark pool activity is generally associated with higher market quality."[7]

The conclusions of this research are borne out by our experience in the U.S. markets, such as the prevalence of very narrow spreads in national market stocks, indicating that effective and efficient price discovery is occurring in the public markets, as well as reduced transaction

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[5] While SIFMA supports enhanced disclosure about HFT and related issues, SIFMA does not support disclosure which may be harmful to or otherwise disadvantage participants or the market, such as disclosing the identity of HFT traders or strategies to the general public.

[6] *See* Letter from Christian Krohn, Managing Director, Association for Financial Markets in Europe & Ann Vlcek, Managing Director, SIFMA, to Werner Bijkerk, Senior Policy Advisor, IOSCO (Feb. 1, 2011). A copy of the letter is enclosed as Exhibit G.

[7] *See* Sabrina Buti, Barbara Rindi and Ingrid M. Werner, Diving into Dark Pools, Fisher College of Business Working Paper, *available at* http://fisher.osu.edu/supplements/10/9860/201010.pdf.

costs, faster execution speeds, ample liquidity and more opportunities for price/size improvement. In addition, by protecting the top of book of U.S. trading centers, the SEC's Order Protection Rule (Regulation NMS Rule 611), which prohibits trade-throughs, is an effective supplement to the duty of best execution in policing execution quality. Studies also indicate there have been improvements in depth of book display beyond the NBBO.[8]

B. Question 2: What are your views on the suggestion that proprietary trading firms (including HFT firms) that are not currently subject to registration/authorization by a regulator should be required to obtain such a registration/authorization? Are there specific regulatory requirements you believe such firms should face? To what extent do your answers differ if the proprietary trading firm accesses the market as the customer of an intermediary firm through DEA (i.e. under that intermediary's trading rules/codes) rather than as a direct member of the market itself?

Proprietary trading firms that directly access exchanges should be regulated entities. However, if firms utilize the memberships of other regulated entities to access the markets, there is no reason for those firms to be directly regulated. The firm providing the market access should maintain appropriate controls regarding the orders that it directs to the market. As discussed more fully below, the SEC recently adopted Rule 15c3-5, which effectively bans direct market access by non-regulated entities.

In the U.S., market participants may access the markets directly or through intermediaries. SIFMA believes that the ability of firms to select the best way in which to conduct their businesses is important to market liquidity and competition. As mentioned above, the SEC recently adopted Rule 15c3-5, which requires broker-dealers that access or provide access to trade directly on an exchange or an alternative trading system ("ATS") to implement risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity.[9] In particular, Rule 15c3-5 requires broker-dealers that provide sponsored or direct market access[10] to customers or other persons (as well as the broker-dealers that use market access to submit their own orders to an

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[8] See Angel, James J., Lawrence E. Harris, Chester S. Spatt, *The Economics of Trading in the 21st Century* (Feb. 23, 2010), 15, *available at* http://www.knight.com/newsRoom/. *See also* Yossi Brandes and Ian Domowitz, Investment Technology Group, Inc., Alternative Trading Systems in Europe: Trading Performance by European Venues Post-MiFID (May 2010), *available at* http://www.itg.com/news_events/papers/ITG-Paper-AlternativeTrading-051910F.pdf (concluding that European dark pools add value to their users by lowering transaction costs and reducing slippage).

[9] Certain requirements of the rule go into effect on November 30, 2011, including those pertaining to fixed income securities, while other requirements of the rule went into effect on July 14, 2011.

[10] As commonly understood, "direct market access" is where the customer's orders flow through the broker-dealer's systems before passing into the markets. Sponsored access is where "the customer's orders flow directly into the markets without first passing through the broker-dealer's systems." *See* Risk Management Controls for Brokers or Dealers with Market Access, Exchange Act. Rel. No. 63241 (Nov. 3, 2010), 75 Fed. Reg. 69792, 69793 (Nov. 15, 2010).

exchange or ATS) to manage the financial, regulatory and other risks of providing such access to exchanges and ATSs. This requirement effectively bans "naked access" in the U.S., an arrangement which allowed market participants to enter trades using a broker-dealer's access to an exchange or ATS without going through the broker-dealer's pre-trade controls. As a result of the new rule, if a proprietary trading firm accesses the market as a customer of an intermediary firm, the broker-dealer offering such access must implement risk controls and supervisory procedures to supervise the risks of that firm's business. Accordingly, because unregistered proprietary trading firms that access the market through regulated intermediaries are already subject to regulation, any additional regulation would be duplicative and unnecessary.

C. Question 3: What recommendations, if any, would you propose to strengthen the regulatory requirements around pre- and post-trade risk controls? In particular, what measures, if any, do you think regulators should introduce that relate specifically to the use of and risks posed by algorithmic trading and/or HFT?

As a general matter, SIFMA supports pre- and post-trade risk controls on market access. As noted above, SEC Rule 15c3-5 requires broker-dealers that access or provide access to trade directly on an exchange or an ATS to implement risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity. SIFMA is less familiar with the structure of the many non-U.S. markets, but we believe that the recent implementation of Rule 15c3-5 in the U.S. may allow IOSCO to observe how the adoption of similar pre-trade controls (along with post-trade surveillance) might address regulatory concerns abroad, including any issues presented by HFT. As noted, SIFMA also believes that more disclosure about HFT may be appropriate.[11]

D. Question 4: To what extent do you believe the use of trading control mechanisms such as circuit breakers and limit-up/limit-down systems by trading venues should be mandated? If you believe they should be mandated, should venue operators be permitted to design their own controls or should they be harmonized/coordinated across venues (including between interrelated instruments such as a derivative and its underlying)?

SIFMA believes that trading mechanisms such as circuit breakers and limit-up/limit-down systems are critical to maintaining efficient, fair and orderly markets during times of extraordinary market volatility. In the U.S., various SROs have issued a plan to implement a limit-up/limit-down system (the "Plan").[12] In particular, the Plan would implement a limit-up/limit-down mechanism to prevent trades in NMS stocks from occurring outside of specific

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[11] *See* SIFMA Comments on Equity Market Structure Concept Release at 6. However, SIFMA does not support disclosure which may be harmful to or otherwise disadvantage participants or the market, such as disclosing the identity of HFT traders or strategies to the general public.

[12] *See* Plan to Address Extraordinary Market Volatility Submitted to the SEC Pursuant to Rule 608 of Regulation NMS under the Exchange Act, Exchange Act Rel. No. 64547 (May 25, 2011), 76 Fed. Reg. 31647 (June 1, 2011).

trading price bands, as well as trading pauses to address more fundamental liquidity events in NMS stocks. SIFMA generally supports the Plan. In particular, SIFMA believes that limit-up/limit-down mechanisms should help to prevent extreme price swings and stock price dislocations that are caused by oversized marketable orders sweeping displayed liquidity to price levels not reasonably related to the value of the security.[13] SIFMA also believes that such mechanisms should significantly help to reduce clearly erroneous, "busted," and adjusted trades. SIFMA's comments recommending certain improvements to strengthen the Plan are attached as Exhibit F. For example, SIFMA believes that certain transactions should be excluded from the Plan, and also that the applicability of the Plan at the open and close of the markets should be carefully analyzed to determine feasibility, given the operational difficulties of administering the Plan at those times.[14]

E. Question 5: To what extent do you believe market maker schemes offered by trading venues should be subject to mandatory minimum criteria? Should the criteria be determined by the trading venue alone? To what extent do you agree with the suggestion that the use of stub quotes should be prohibited?

SIFMA supports the elimination of stub quotes, and also obligations requiring market makers to quote within a reasonable range based on the NBBO. However, any further obligations imposed upon market makers need to be accompanied by adequate incentives that encourage market makers to continue to provide liquidity to the marketplace, or such obligations could do more harm than good. If obligations are set too high, without supporting incentives, such changes could reduce liquidity in the market.

F. Question 6: Do you have suggestions for improvements to regulators' surveillance capabilities with respect to the markets and modern trading techniques? Please elaborate.

Who should bear the cost of investing in such capabilities and the cost of operating and supervising the markets in order to ensure fairness among market participants? Please elaborate.

SIFMA appreciates the importance of ensuring that regulators have access to appropriate surveillance tools. However, we believe that careful consideration should be given to the cost-benefit analysis of such initiatives to ensure that regulatory goals are met as efficiently as possible.

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13 *See* SIFMA Comments on the Plan at 2.

14 *Id*. at 4, 8.

For example, in the U.S., the SEC recently adopted a rule requiring large traders to obtain a unique identifier that will facilitate the ability of regulators to more readily identify their trading when requesting information from broker-dealers.[15] In addition, the SEC has proposed the creation of a consolidated audit trail for NMS securities to allow the SEC and SROs to more effectively regulate trading activities across markets and market participants.[16] We support the creation of a consolidated audit trail in concept because we believe it would significantly enhance the ability of the SEC and SROs to meet their monitoring, enforcement, and other regulatory obligations under the federal securities laws. In addition, we believe the consolidated audit trail initiative presents an opportunity to eliminate inefficient and redundant individual SRO reporting systems in place today.[17] However, while SIFMA supports this initiative in theory, we believe that the consolidated audit trail as proposed by the SEC is overly ambitious and that there are other approaches that would be just as effective in reaching the SEC's goals, with a substantially lesser burden and cost to the industry and, ultimately, all investors and which could be implemented much more quickly.[18]

As proposed by the SEC, the consolidated audit trail is overly broad in scope and would impose enormous costs on SROs and broker-dealers. The real-time reporting requirement alone would be extremely expensive to implement and maintain, and the SEC has not clearly articulated what regulatory benefits would be derived from having this broad set of data elements available on a real-time basis.[19] Indeed, SIFMA continues to question the need for real-time reporting of the entire set of data elements set forth in the SEC's proposal, and believes that reporting on a "T + 1" (or, in some cases, later) basis should satisfy the SEC's stated regulatory objectives more efficiently.[20] In this regard, SIFMA believes the SEC should build upon an existing audit trail, such as the Financial Industry Regulatory Authority's ("FINRA") Order Audit Trail System ("OATS"), rather than create an entirely new system. In sum, SIFMA

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[15] *See* Large Trader Reporting, Exchange Act Rel. No. 64976 (July 27, 2011), 76 Fed. Reg. 46,960 (Aug. 3, 2011).

[16] *See* Consolidated Audit Trail, Exchange Act Rel. No. 62174 (May 26, 2010), 75 Fed. Reg. 32,556 (June 8, 2010) (the "Consolidated Audit Trail Proposal.")

[17] *See generally* SIFMA Comments on Consolidated Audit Trail.

[18] *Id.*

[19] We note that the substantial costs to create and operate a consolidated audit trail system would be difficult for SROs to fund. In particular, the SEC estimates that the consolidated audit trail system would cost $4 billion to implement and $1.7 billion in annual operating costs. Although SIFMA believes that the SEC's estimate of operating costs is too low, these costs would be difficult for SROs to fund because of their uneven revenue sources and their limited ability to impose fees on members. If the SEC maintains that the SROs must pay to construct and maintain the consolidated audit trail system, SIFMA believes that the SEC may be forced to raise or eliminate the caps it has on transaction fees on exchanges in order to give the SROs more flexibility to obtain money to fund the new system. *Id*. at 22.

[20] *See* Letter from James T. McHale, Managing Director and Associate General Counsel, SIFMA, to David Shillman, Associate Director, Division of Trading and Markets, SEC (Jan. 12, 2011) (SIFMA "drop copy" counterproposal). A copy of this letter is attached as Exhibit H. We note in this proposal that, if the SEC ultimately requires reporting of certain data elements in real-time or near real-time, such data should be limited to reporting of "key business events," as defined in the counterproposal.

believes that the overall costs associated with the proposed consolidated audit trail could be significantly reduced, without undermining the regulatory goals of the initiative, by limiting the data required to be produced under the consolidated audit trail and by permitting broker-dealers to report on a T + 1 or later basis. This would benefit not only the broker-dealer industry, but all investors in NMS securities to whom such costs inevitably will be passed down.

G. Question 7: What do you perceive as the major causes of settlement indiscipline and settlement failures? What steps, if any, do you believe regulators should take to address these causes?

SIFMA is not aware of significant issues with securities settlement in the U.S. that would merit additional measures by regulators.

H. Question 8: Have the appropriate steps been taken to limit or manage conflicts of interest that arise where an investment firm simultaneously conducts client-serving activities and proprietary trading or a trading participant is also a shareholder in a venue on which it trades? If you believe conflicts management is inadequate, please explain how this manifests itself and any recommendation you have for how conflicts management could be improved.

Significant steps have been taken by U.S. regulators to limit or manage potential conflicts of interest that arise when an investment firm simultaneously conducts client-serving activities and proprietary trading, or when a trading participant is a shareholder in a venue on which it trades. First, the SEC and SROs have adopted customer protection rules to ensure that broker-dealers place the interests of customers before their own. For example, a broker-dealer that accepts and holds an order for an equity security from a customer without immediately executing the order is prohibited from trading that security on the same side of the market for its own account, at a price that would satisfy the customer order, unless it immediately thereafter executes the customer order up to the size and at the same or better price at which it traded for its own account.[21] Second, SEC rules require the display of certain customer limit orders.[22] In addition, the SEC requires that for-profit exchanges adopt governance measures to protect their

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[21] *See* FINRA Rule 5320. *See also* New York Stock Exchange (the "NYSE") Rule 92, and NYSE's recent rule filing to rescind Rule 92 and adopt a new NYSE Rule 5320, similar to FINRA's rule (SR-NYSE-2011-43). FINRA also has published a concept proposal that would require firms, at or prior to commencing a business relationship with a retail customer, to provide a written statement that describes conflicts associated with the services it provides to clients, amongst other information. One of the disclosures proposed to be included in the written statement is a disclosure of conflicts that may arise between a firm and its customers and how the firm manages such conflicts. *See* Disclosure of Services, Conflicts and Duties, FINRA Regulatory Notice 10-54 (Oct. 2004), *available at* http://www.finra.org.

[22] For example, Rule 604 of Regulation NMS, the Limit Order Display Rule, requires the display of customer limit orders by OTC market makers and exchange specialists. *See* Exchange Act Rule 604.

self-regulatory functions from their business interests.[23] At the NYSE, for example, NYSE Regulation, Inc., the non-profit entity that is dedicated to strengthening investor protection and market integrity, is a separate legal entity from the New York Stock Exchange LLC.[24] This organizational structure preserves the separation between the NYSE's business and regulatory functions.[25] Other exchanges have similarly segregated their business and self-regulatory functions. Lastly, at the SEC's urging, U.S. exchanges have adopted limits on the ownership and voting rights that a broker-dealer member can have when investing in an exchange.[26] These steps help address conflicts of interest that may exist because of the multiple roles that a broker-dealer may fulfill.

I. Question 9: Do you think existing laws and rules on market abuse and disorderly trading cover computer generated orders and are relevant in today's market environment?

As further explained in the SIFMA Comments on Equity Market Structure Concept Release, SIFMA believes that regulators may better serve investors by relying on general antifraud rules to prevent market abuse and disorderly trading, rather than attempting to engage in line drawing.[27] In the U.S., for example, SIFMA believes that existing antifraud rules are sufficient to allow securities regulators to address discrete situations in which market participants engage in fraudulent or manipulative activity.[28] SIFMA also believes that adopting rules that

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[23] In 2004, the SEC proposed a rule which would require exchanges and associations to establish policies and procedures to maintain separation between their regulatory functions and their market operations and other commercial interests. *See* Fair Administration and Governance of Self-Regulatory Organizations; Disclosure and Regulatory Reporting by Self-Regulatory Organizations; Recordkeeping Requirements for Self-Regulatory Organizations; Ownership and Voting Limitations for Members of Self-Regulatory Organizations; Ownership Reporting Requirements for Members of Self-Regulatory Organizations; Listing and Trading of Affiliated Securities by a Self-Regulatory Organization, Exchange Act Rel. No. 50699 (Nov. 22, 2004) (the "SRO Proposal"). Although this rule was never adopted, U.S. exchanges have largely adopted its requirements.

[24] *See* NYSE Regulation: Investor Protection, http://www.nyse.com/regulation/about/1045516499685.html.

[25] *Id*.

[26] In the SRO Proposal, the SEC also proposed to require national securities exchanges and registered securities associations to prohibit any member that is a broker or dealer from owning and voting more than 20% of the ownership interest in the exchange or the association, or a facility of the exchange or association. Similar to the requirements on the separation of the regulatory and commercial interest of exchanges, this requirement was never adopted, but nevertheless has been adopted by U.S. exchanges.

[27] *See* SIFMA Comments on Equity Market Structure Concept Release at 10.

[28] For example, FINRA censured and fined Trillium Brokerage Services, LLC $1 million for using an illicit HFT strategy, through nine propriety traders, to generate non-bona fide market moving orders to generate selling or buying interest in specific stocks. FINRA brought the action alleging violations of a number of its rules, including NASD Rule 2120, which prohibits the use of deceptive, manipulative or other fraudulent devices. *See* FINRA Sanctions Trillium Brokerage Services, LLC, Director of Trading, Chief Compliance Officer, and Nine Traders for $2.26 Million for Illicit Equities Trading Strategy, *available at* http://www.finra.org/Newsroom/NewsReleases/2010/P121951. Please note, NASD Rule 2120 has been renumbered as FINRA Rule 2020.

require market participants to provide certain information to regulators regarding HFT strategies may be an effective way to help regulators prevent market abuse and disorderly trading activity.

J. Question 10: Are there any strategies employed by HFT firms that raise particular concerns? If so, how would you recommend that regulators address them?

As further explained in the SIFMA Comments on Equity Market Structure Concept Release, SIFMA cautions regulators against hastening to categorize HFT trading strategies as "beneficial" or "harmful."[29] In the first instance, absent clear fraud or manipulation, we believe that engaging in such line drawing on a broad basis is fraught with difficulties. For example, market participants have long been astute to the possibility of other orders in the market that, if executed, could have a serious impact on the value of their portfolios. Thus, strategies designed to anticipate the trading of other market participants are not novel concepts, and the ability to identify buyers and sellers in the market – absent fraud, manipulation, or a breach of duty – should not result in prohibitions on a strategy that aims to make such determinations. In addition, existing trading strategies, whether for HFT or otherwise, will evolve in ways that inevitably will outpace regulatory efforts to categorize them, and entirely new trading strategies similarly will develop at a rapid pace.

As noted above, rather than taking a path that will require continuous line drawing, SIFMA believes that regulators would better serve investors by: (1) relying on their general antifraud authority to address discrete situations in which market participants engage in fraudulent or manipulative activity; and (2) adopting rules that would facilitate the provision of certain information about HFT strategies to the regulator.

K. Question 11: Should charges or fees be imposed on messages, cancellations or high order-to-trade ratios? If so, how should the fees or charges be determined and on what basis?

An accurate, timely, and accessible NBBO is critical for the proper functioning of the markets – especially in the fast paced world of electronic trading. As discussed in our comment letter on the SEC Equity Market Structure Concept Release, SIFMA believes that artificial minimum duration or delays are inadvisable. SIFMA believes that imposing charges or fees on messages, cancellations, or high order-to-trade ratios raises extremely complex and difficult issues. Any regulatory initiatives in these areas warrant in depth study of the impact that such charges or fees would have on the markets.

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[29] *See* SIFMA Comments on Equity Market Structure Concept Release at 9.

L. Question 12: Should market operators be required to make their co-location services available on a fair and non-discriminatory basis?

SIFMA believes that co-location facilities should be made available to exchange members and other persons using such facilities on fair and reasonable terms and pursuant to fees that are equitably allocated among members and other persons using those facilities.[30] Under these circumstances, we do not view co-location arrangements as conferring an unfair advantage to firms that use them or as creating a "two-tiered" market. SIFMA also believes that added disclosure about co-location and other market access arrangements would be beneficial to market participants. Such disclosures might describe standard, high speed, co-location or other means by which members may access an exchange or ATS, and also provide market participants with details regarding the category of market participants that use each means of access, the data capacity associated with each arrangement, and the quotation or transaction volume attributable to each arrangement.

M. Question 13: Should market operators be required to provide testing environments to enable participants to stress test their algorithms? If so, what kind of minimum requirements are reasonable?

SIFMA generally believes that, in the U.S., exchange testing platforms are sufficient to allow for functional testing of algorithms. Specifically, they are adequate for testing basic connectivity, robustness of the communication protocols (e.g., FIX), and validation of order parameters. The creation of a testing platform that would provide testing results similar to those that would be achieved when an algorithm is in production would, in our view, be difficult to achieve and prohibitively expensive. Rather, firms should be required to ensure that their order placement strategies, via algorithm or otherwise, are subject to appropriate risk controls, including pre-trade order acceptance checks.

N. Question 14: To what extent do you have other comments related to the risks to market integrity and efficiency raised by the issues in this report?

SIFMA appreciates the efforts of the Committee in evaluating the impact that technology has had on market integrity and efficiency. We believe that the integrity of market data throughout the various markets of IOSCO participants is an issue that must be considered by the Committee and, indeed, is critical to any ultimate findings on market integrity and efficiency. Market participants generally, including those engaged in HFT and other algorithmic trading, rely on accurate and timely market data for trading, risk management and surveillance purposes. Similarly, the availability of valid market data underlies the efforts of securities regulators in effectively surveiling the markets, as well as in implementing rules and safeguards to reduce excess market volatility, such as exchange circuit breakers, limit-up/limit-down mechanisms, and trading pauses. Therefore, we urge the Committee to consider the quality of market data and, where appropriate, ways in which the quality of market data might be enhanced when assessing the issues in the Report.

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[30] *See* SIFMA Comments on Equity Market Structure Concept Release at 6.

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SIFMA appreciates this opportunity to comment on the issues raised in the Report. If you have any comments or questions, please do not hesitate to contact me at 202.962.7300.

Sincerely,

/s/ Ann Vlcek

Ann Vlcek
Managing Director and
Associate General Counsel
SIFMA

cc: Mary L. Schapiro, Chairman
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U.S. Securities and Exchange Commission

Robert Cook, Director, Division of Trading and Markets
U.S. Securities and Exchange Commission

Exhibit A - Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (Apr. 16, 2010) (SIFMA's comments on the SEC's proposal to adopt a rule requiring risk management tools for broker-dealers with market access)

SIFMA
Securities Industry and
Financial Markets Association

April 16, 2010

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

Re: Exchange Act Release No. 61379; File No. S7-03-10; Risk Management Controls for Brokers or Dealers with Market Access

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on Securities Exchange Act ("Exchange Act") Release No. 61379, in which the Securities and Exchange Commission (the "SEC" or "Commission") requested comment on a proposal to adopt a rule requiring risk management controls for broker-dealers with market access (the "Proposal"). The Proposal would require broker-dealers with access to trade directly on an exchange or an alternative trading system ("ATS") to implement risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity.

I. Introduction

In broad terms, the Proposal to adopt new Exchange Act Rule 15c3-5 would require broker-dealers that provide sponsored or direct market access to customers or other persons to manage the financial, regulatory, and other risks of providing such access to exchanges and ATSs. The Proposal would require pre-trade controls and supervisory procedures to be under the "direct and exclusive" control

[1] The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

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of the sponsoring broker-dealer, even if provided through a vendor system. These controls and procedures are required to be applied on an automated, pre-trade basis before orders are routed to an exchange or ATS. Thus, the Proposal would, as the proposing release notes, effectively prohibit the practice of what has become known as "unfiltered" or "naked" access.

SIFMA supports the general principle underlying the Proposal that pre-trade and post-trade controls and procedures are appropriate in sponsored access arrangements.[2] The Proposal creates a consistent standard for these pre-trade and post-trade controls across markets. SIFMA believes that a uniform requirement for such controls and procedures is useful in mitigating the systemic risks that sponsored access can potentially present. In addition, SIFMA supports the policies and procedures approach of the Proposal.

SIFMA, however, believes the rule should not be adopted until significant complex issues are addressed. In particular, the Proposal's simple structure raises complex issues regarding its application to well-established industry practices, which do not themselves involve heightened systemic risk concerns. These issues include:

- the application of the Proposal to situations where multiple broker-dealers are involved in routing an order to a market center (such as an introducing broker, clearing broker, executing broker, routing broker, inter-dealer broker, and floor broker);

- the treatment under the Proposal of third-party risk management software, including risk management software that is offered by market centers (which is commonly used today);

- the role of market centers in monitoring compliance with the proposed rule;

- the proposed rule's treatment of certain regulatory concerns, such as insider trading, market manipulation, and margin rules; and

- that the Proposal would not apply to non-exchange and non-ATS venues.

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[2] In this letter, the term "pre-trade" refers to the period of time prior to and including order entry, as well as the period of time during which an order has been entered but has not yet been executed (*i.e.*, open orders); "post-trade" refers to the period of time after an order is executed.

There also are additional significant operational and compliance considerations that the SEC should consider as it contemplates a final rule. SIFMA believes that it is critical to resolve these issues in a workable manner before considering moving forward with the Proposal.

II. Multiple Broker-Dealer Roles

Given the operational nature of the rule and that multiple broker-dealers may play various roles in executing a transaction, the Proposal presents complications that the Commission should consider. For example, many trading arrangements involve several broker-dealers, each of whom undertakes a different role in the transaction.

Specific examples of situations where multiple broker-dealers are involved in executing an order include:

- an introducing broker-dealer routes its customer orders to an exchange through an access broker-dealer and clears through a separate clearing broker;
- a clearing firm provides order entry systems to introducing firms for use by the introducing firm's investment professionals, home office or retail investors;
- an executing broker for a hedge fund uses a broker-dealer to access an ATS and clears the trade through a separate prime broker;
- a broker-dealer uses another broker-dealer for access to exchanges of which it is not a member for its own proprietary and institutional customer accounts;
- a broker-dealer uses a smart order router or algorithm provided by another broker-dealer;
- a NYSE member gives an order to a NYSE floor broker for execution; and
- a retail broker routes orders to options markets through consolidators.

In each of the examples noted above, we assume that only the broker-dealer whose identifier is used to provide access to an exchange or ATS would be directly subject to the rule. Applying the rule to *all* of the broker-dealers involved

in the execution and clearing of a transaction, some of whom may have a limited role, would be unnecessary and duplicative.

As a threshold matter, responsibility for compliance with the market access rule should be the obligation of the broker-dealer providing access to an exchange or ATS rather than an obligation of all the broker-dealer participants in the transaction. However, in certain circumstances the broker-dealer providing access may not be in the best position to control financial and regulatory risks associated with transactions for other broker-dealers or customers, and financial and regulatory controls may already be assumed by other broker-dealers involved in the transaction. It may be redundant or, in some cases, extremely impractical to require the broker-dealer providing access to apply all of the required pre- and post-trade controls and procedures to each order.

SIFMA believes that the rule should allow the broker-dealer providing market access to reasonably rely on the risk procedures operated by another broker-dealer in the transaction in particular situations where that other broker-dealer is in a better position to carry out these procedures. In these situations, the broker-dealer providing market access should have its own procedures to support such reliance, which could include receiving representations and warranties from the broker-dealer on which it is relying and annually recertifying the arrangement as a part of renewing access arrangements. In this way, the broker-dealer with the most effective access to the information required by the Proposal, and with the most effective ability to control the risk presented by a given order, would be able to use that information and take the steps necessary to mitigate risk.

Some SIFMA members believe that a broker-dealer should be free to determine which broker-dealer is best positioned to apply the required risk procedures.[3] Other SIFMA members believe that the rule should specifically allocate responsibility for risk management controls and procedures to executing and clearing broker-dealers based on the executing and clearing broker-dealers' access to information and the role that each plays in the trading process. These allocations would take into account which controls and procedures are appropriate on a pre-trade basis and post-trade basis, and would allocate pre-trade, order-

[3] This approach would be consistent with NYSE Rule 382 and NASD Rule 3230, which require broker-dealers providing brokerage services to customers pursuant to an agreement to allocate responsibilities between themselves based on an assessment of which broker-dealer is best positioned to carry out a particular function. The approach also would be similar to Rule 203(b) of Regulation SHO which provides an exception from the locate requirement if a broker-dealer receives a short sale order from another broker-dealer that is required to comply with the locate requirement.

based controls to the broker-dealer providing access and post-trade credit controls to the clearing firm.

As the Commission studies the effect the Proposal would have on various common trading arrangements, SIFMA would be happy to discuss the alternatives outlined above with the Commission or its staff.[4] Indeed, we believe that it is critical for the Commission to consider the operational challenges presented by the Proposal before implementing a final rule in order to avoid unintended consequences and to ensure that the new rule mitigates the systemic risk concerns that the Proposal is intended to address.

III. "Direct and Exclusive" Control Requirement and the Use of Third Party Software

The Proposal requires that the financial and regulatory risk management controls and supervisory procedures be under the "direct and exclusive" control of the broker-dealer that is providing market access. The proposing release states that broker-dealers "would have the flexibility to seek out risk management technology developed by third parties, but the Commission expects that the third parties would be independent of customers provided with market access."[5] Given that many broker-dealers rely on such third party software that is often under the control of a third party vendor, the Commission should clarify that the underlying software can, in fact, be under the control of a third party vendor, provided that the broker-dealer is able to control the parameters and thresholds applied by the software. In addition, the Commission should clarify that software provided by exchanges and ATSs could be one of the tools a broker-dealer could use to satisfy its control or surveillance obligations, assuming the broker-dealer can control the parameters of such software.

The Commission could assist firms in understanding the contours of the "direct and exclusive" control requirement by providing a non-exclusive list of examples

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[4] We also note that various SIFMA member firms are submitting their own comment letters on the Proposal, which will discuss more fully the alternatives outlined above and variations on these alternatives.

[5] The SEC should clarify that the term "independent" refers to a third party vendor that is not a controlled affiliate of a customer to which a broker-dealer provides sponsored access. In other words, SIFMA does not believe that non-controlled-affiliates should be excluded from providing third party software.

In addition, the proposing release states that "independence" would be expected. The SEC should clarify that independence is required.

where the SEC would and would not consider third party arrangements to satisfy the rule.

IV. The Role of Market Centers in Applying Controls and Procedures

As noted above, many market participants rely on risk management software provided by exchanges and ATSs. One of the reasons that market participants do so is that market centers in many instances are particularly well-suited to apply pre-trade controls to order flow. For example, orders not reasonably related to the market, trading halts, and clearly erroneous orders could be monitored by a market center.[6] Where such controls do exist at the market center level, the Commission should clarify that they can be relied upon by broker-dealers providing market access. Market centers may be less able to monitor for other standards, such as credit limits; therefore, it is appropriate for broker-dealers to monitor these standards without use of a market center's systems.

V. Application of Regulatory Controls Requirement / Timing of Surveillance Reviews

The Proposal requires risk management controls and procedures to be reasonably designed to ensure compliance "with all regulatory requirements." "Regulatory requirements" is defined broadly to include "all federal securities laws, rules and regulations, and rules of self-regulatory organizations, that are applicable in connection with market access." As proposed, the rule could conceivably be interpreted to require a firm providing market access to have controls and procedures reasonably designed to prevent the entry of orders that are manipulative or are based on inside information, as the rule requires controls and procedures reasonably designed to "ensure compliance with all regulatory requirements."[7] The SEC should clarify in the adopting release that broker-dealers providing market access would not be liable for regulatory requirements that are only tangentially related to accessing the market, such as margin requirements, or violative behavior that depends on the intent of the sponsored customer.

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[6] SIFMA notes that erroneous order policies in options are not consistent across exchanges, and therefore controls would be difficult to program / identify on a pre-trade basis. The SEC should encourage exchanges to develop consistent methodologies for identifying and implementing erroneous order policies.

[7] The order approving amendments to Nasdaq Rule 4611, approved on January 13, 2010, notes that the rule requires monitoring of "illegal activity such as market manipulation or insider trading." Exchange Act Release No. 61345 (January 12, 2010). SIFMA notes that this requirement raises the same issues discussed in this letter.

In addition, SIFMA notes that surveillance for market manipulation and other fraudulent activity is really only possible on a post-trade basis. Insider trading, for example, can only be detected after the relevant inside information is made public. The Commission should make clear that monitoring for insider trading is not required by the Proposal. In addition, effective monitoring and surveillance of trading activities requires a view across trading venues, which a sponsoring broker-dealer may not have for a particular customer. Moreover, manipulative patterns generally require a view of a range of trading. For this reason, most broker-dealers do not routinely monitor for manipulative trading on a real-time basis. Thus, the SEC should confirm that firms would be in compliance with the rule by monitoring for manipulative activity on a delayed (*e.g.*, T+1) post-trade basis. Of course, a provider of market access should not be permitted to ignore behavior or a pattern of activity that is obviously violative.

In addition, the Proposal requires that a broker-dealer's market access controls and procedures assure that appropriate surveillance personnel receive immediate post-trade execution reports. Many firms already have systems and procedures in place for post-trade data to be reviewed on a T+1 basis, for the reasons that are discussed above. For purposes of clarity, the SEC should clarify in the adopting release that this requirement could be satisfied by using a broker-dealer's existing surveillance infrastructure, *i.e.*, there does not need to be a distinct surveillance team dedicated to reviewing market access information.

VI. Application of the Rule to Non-Exchange and Non-ATS venues

The Proposal applies to "market access," defined as "access to trading in securities on ***an exchange or alternative trading system*** . . ." (emphasis added). Thus, the Proposal does not cover access to execution venues that are not exchanges or ATSs, such as over-the-counter market makers and other "upstairs" trading. Nor does the Proposal cover access to an ATS that is provided directly to subscribers by the ATS itself. The Commission should clarify that nothing in the Proposal would preclude the continued application of self-regulatory organization guidance that requires broker-dealers to apply risk controls and procedures to orders that are sent to non-exchange and non-ATS trading venues or to internal ATS venues. For example, NASD Notice to Members 04-66 reminds member firms that enter, or permit customers or non-FINRA members to enter, orders into the handling, routing, and execution services of a vendor, automated trading system, electronic communications network, or other market center "to take steps to ensure that such orders are free of errors and representative of bona fide transaction and quotation activity" and that they must have in place "supervisory systems and written supervisory procedures" with respect to order accuracy,

preset credit and order-size parameters, among other things. This guidance should continue to apply to avoid creating a significant regulatory gap.

VII. Additional Significant Operational and Compliance Concerns

In addition to the concerns discussed above, the Proposal would benefit from clarification regarding the application of capital and credit thresholds, duplicative orders, the Chief Executive Officer ("CEO") certification requirement, and compliance exams that review a firm's compliance with the rule.

A. Capital and Credit Thresholds

The SEC should clarify several matters with respect to capital and credit thresholds, including that:

- under the rule, firms would have the flexibility to make intraday exceptions to any established thresholds based on changes in market or customer conditions;

- the rule would require limits to be set at the broker level, *i.e.*, a clearing firm would look at the introducing broker, not the client of the introducing broker;

- there are situations where thresholds may not be appropriate, such as:

    - where there are sufficient assets on account to mitigate any market exposure in light of the client's trading;

    - where executing broker accounts settle at prime brokers and the prime broker is extending credit;

    - where retail or institutional brokerages execute trades on an agency basis for many accounts, which makes it impossible and impractical to establish a "credit or capital threshold" as neither the sponsored party's credit or capital, or for that matter the assets of any individual investor, is a risk mitigator as trading is being conducted for many investors; and

- it would be a reasonable procedure for a broker-dealer to set thresholds with reference to the aggregate market access that the broker-dealer provides, as broker-dealers are often not aware of a sponsored participant's activity through other broker-dealers.

B. Duplicate Orders

The Proposal indicates that a broker-dealer that provides market access would be obligated to monitor for, and prevent the entry of, orders that indicate duplicative orders. Determining which orders are duplicative would be difficult to achieve, especially when the typical behavior for many clients is to trade in small order sizes. Requiring potentially duplicative orders to be rejected could result in a disadvantageous execution for a client if the order is indeed not duplicative. While we recognize that certain monitoring protocols can be implemented, such as checking whether client orders are being sent with the same ID, there should not be a requirement to prevent or reject these orders as clients may recycle order IDs intra-day. Thus, the Commission in the adopting release for the rule should recognize the difficulty and limits in monitoring for duplicate orders.

C. CEO Certification

The Proposal requires a sponsoring broker-dealer to review annually the business activity of market access to assure the overall effectiveness of the firm's risk management controls and supervisory procedures. A firm's CEO (or equivalent officer) is required to certify annually that the firm's risk management controls and supervisory procedures comply with the rule, and that the firm has conducted the required annual review and assessment. The SEC should clarify that the CEO certification could be completed as a part of existing review and certification processes, such as the FINRA Rule 3130 certification. That is, the adopting release should note that the same process and certificate used for FINRA Rule 3130 certifications could be used to satisfy the Rule 15c3-5 requirement.

D. Compliance and Exams

In the adopting release, the SEC should make clear that, in light of the policies and procedures approach of the rule, the SEC and other self-regulatory organizations should examine firms with a view toward improving procedures, as opposed to taking the view that any trading error is per se a violation of the rule.

* * * * * *

As stated above, we believe that the Proposal presents complex issues that are not addressed by the Proposal in its present form. These complexities should be addressed prior to adoption of a final rule. We support the principles underlying the Proposal, and believe that our above comments and suggestions, if reflected in the final rule, would serve to strengthen the rule and further the goals of maintaining market integrity and mitigating systemic risk.

We would be pleased to discuss these comments in greater detail with the Commission and its staff. If you have any comments or questions, please do not hesitate to contact me at 202.962.7300.

Sincerely yours,

Ann Vlcek
Managing Director and Associate
General Counsel
SIFMA

cc: Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
Kathleen L. Casey, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
Robert W. Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets

Exhibit B – Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (Apr. 29, 2010) (SIFMA's comments on the SEC's concept release on the market structure of the U.S. securities market)

SIFMA
Securities Industry and
Financial Markets Association

April 29, 2010

By Electronic Mail (rule-comments@sec.gov)

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Concept Release on Equity Market Structure: Release No. 34-61358; File No. S7-02-10

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] welcomes the opportunity to comment on the Securities and Exchange Commission's ("SEC" or "Commission") concept release ("Concept Release") on equity market structure.[2] We appreciate the timeliness of the Commission's review, and we are pleased to comment on the range of issues discussed in the Concept Release, including, among others, the performance of the equity markets, high frequency trading ("HFT") and undisplayed liquidity. It has been ten years since the Commission's last general review of the equity markets,[3] and much has changed during that time. For example, there have been significant developments in the over-the-counter ("OTC")

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[2] Exchange Act Rel. No. 61358 (Jan. 14, 2010), 75 Fed. Reg. 3594 (Jan. 21, 2010) ("Concept Release"). In addition to the Concept Release, the Commission has issued a number of proposals and adopted rules related to equity market structure during the past months. *See, e.g.*, Exchange Act Rel. No. 61595 (Feb. 26, 2010), 75 Fed. Reg. 11232 (Mar. 10, 2010) (adopting a short sale price test and other amendments to Regulation SHO); Exchange Act Rel. No. 61379 (Jan. 19, 2010), 75 Fed. Reg. 4007 (Jan. 26, 2010) (proposing risk management controls for broker-dealers with market access) ("Market Access Release"); Exchange Act Rel. No. 60997 (Nov. 13, 2009), 74 Fed. Reg. 61208 (Nov. 23, 2009) (proposing rules regarding non-public trading interest); Exchange Act Rel. No. 60684 (Sept. 18, 2009), 74 Fed. Reg. 48632 (Sept. 23, 2009) (proposing a ban on flash orders); Exchange Act Rel. No. 60388 (Jul. 27, 2009), 74 Fed. Reg. 38266 (Jul. 31, 2009) (adopting various amendments imposing the so-called "close-out" requirement in Interim Temporary Final Rule 204T of Regulation SHO).

[3] *See* Exchange Act Rel. No. 42450 (Feb. 23, 2000), 65 Fed. Reg. 10577 (Feb. 28, 2000) (requesting comment on issues relating to market fragmentation) ("Market Fragmentation Release").

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market, including the registration of Nasdaq as a national securities exchange. There also have been dramatic improvements in information processing and communications technology, facilitating the development of new trading strategies, such as HFT. The growth of trading on undisplayed liquidity venues, increased competition among trading centers and the resulting dispersion of order flow, Regulation NMS, and regulatory consolidation (e.g., the creation of the Financial Industry Regulatory Authority ("FINRA")[4]) all have contributed to a market that differs in numerous ways from that reviewed ten years ago.

Notwithstanding generalizations to the contrary, SIFMA believes that the market structure changes discussed in the Concept Release cannot be universally characterized as favorable or unfavorable market developments. They are more complex in that they represent advancements for investors and the markets in some sense, yet they may also present issues in terms of certain national market system ("NMS") goals. The challenge is to recognize and realize the benefits offered by these developments while working to carefully address any associated, valid regulatory concerns. We believe the Commission should evaluate each of the issues presented in the Concept Release in light of its ability to promote key and distinct NMS goals: (1) efficient pricing and best execution; (2) market liquidity; (3) market transparency; (4) fair and orderly markets; and (5) competition among markets and investor choice.

Section I of this letter discusses SIFMA's views regarding the current performance of our equity markets. Section II offers our comments on a number of market structure issues raised in the Concept Release, including HFT and undisplayed liquidity, among others. In addition to evaluating current equity market structure and the issues in the Concept Release, we believe it is important to take a longer-term look at the direction of the equity markets. Section III therefore sets forth suggested equity market goals and regulatory initiatives that market participants and regulators should work toward in the near future, including the need for additional market data reform to protect the interests of retail investors. We look forward to discussing our comments and any other issues with the Commission as it continues its market structure review.

I. Equity Market Structure: Governing Principles and Current Performance

A. Governing Principles

Section 11A of the Securities Exchange Act of 1934 ("Exchange Act") sets out the principles of the NMS, all of which Congress deemed were to be achieved through a system of competing markets linked through technology.[5] These principles include:

- economically efficient execution of securities transactions;
- fair competition among brokers and dealers and between markets;

[4] FINRA was formed by a consolidation of the enforcement arm of the New York Stock Exchange ("NYSE"), NYSE Regulation, Inc., and the National Association of Securities Dealers ("NASD") in 2007. *See* Exchange Act Rel. No. 56145 (Jul. 26, 2007), 72 Fed. Reg. 42169 (Aug. 1, 2007).

[5] *See* H.R. Rep. 94-123, 94th Cong., 1st Sess. 50 (1975).

- availability of quotation and transaction information;
- practicability of executing investors' orders in the best market; and
- an opportunity, consistent with economically efficient execution and the practicability of executing investors' orders in the best market, for investors' orders to be executed without the participation of a dealer.[6]

As the Commission has acknowledged, the various NMS goals may be difficult to reconcile at times.[7] For example, intermarket competition implies a greater dispersion of order flow than might otherwise be the case in a centralized equity market and this, in turn, requires greater efforts by broker-dealers to achieve best execution. Similarly, the Concept Release raises questions regarding the aligned or contrasting interests of long-term investors and professional traders – the resolution of which may have policy implications in assessing how best to advance the NMS in any particular instance.[8] Notwithstanding these and other tensions, NMS goals clearly remain the touchstone in evaluating current market structure. Restating them somewhat, SIFMA believes these NMS principles equate to ensuring that Commission regulations promote efficient pricing and best execution; facilitate market liquidity; promote market transparency; maintain fair and orderly markets; and preserve competition among markets so as to provide investors alternatives for meeting their financial objectives.

In particular, SIFMA believes that robust competition and innovation are hallmarks of the US equity markets, and that regulation that unnecessarily limits competition dampens the incentive to innovate. Instead, regulation should encourage fair competition among broker-dealers and among markets because such competition inevitably leads to greater choices for investors, which facilitates efficient pricing and best execution. As discussed below, we are concerned that regulation that functionally rewards market participants that have not kept pace with market developments by easing competitive pressures to perform efficiently and effectively in the marketplace will hinder further market development, stifle innovation, and disadvantage our markets and US investors in the global marketplace.

B. Current Equity Market Structure

Our current equity markets are characterized by efficient and effective linkages and healthy competition among markets and market participants. This is demonstrated not only by statistics cited in the Concept Release and other studies, described below, but also through the practical observation of the markets. For example, during the 2008 financial crisis, trading in the equity markets continued without a significant hitch, permitting investors to find liquidity even during this volatile period. This is in contrast to the liquidity freezes and instability that were evident in other markets (i.e., the credit markets) during that time.

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[6] Exchange Act Section 11A(a)(1)(C), 15 USC § 78k-1(a)(1)(C).

[7] Concept Release at 3597.

[8] *Id.* at 3596.

The Concept Release discusses various trends that, in our view, affirm the strength of the equity markets. For example, the SEC notes a significant amount of order flow dispersion among various market centers, focusing on the dispersion of order flow of NYSE-listed companies in particular.[9] We view such order flow dispersion as a sign of healthy intermarket competition.[10] The Commission also notes that execution speeds have improved significantly. This too, we believe, is a benefit to our markets as increased transaction speed is important to obtaining best execution in increasingly automated markets. In fact, among the more important outcomes of Regulation NMS were the elimination of the antiquated Intermarket Trading System ("ITS") rules and the enhancement of quote accessibility/firmness brought about by mandating that only automated quotes may receive trade-through protection.

Other researchers have noted similar advancements in the equity markets. One study points out an increase in average daily traded volume ("ADTV") from three billion shares in 2003 to ten billion shares in 2009.[11] Average trade sizes have shrunk, perhaps due to the rise in algorithmic trading; however, bid-offer spreads are tighter than ever before.[12] Commissions also remain at low levels. Intermarket trade-through protection (the Order Protection Rule ("OPR"), Rule 611 of Regulation NMS) has facilitated increasingly efficient private linkages between trading centers – replacing the less efficient ITS linkage. We also note that the Commission and FINRA are engaged in rulemaking that should provide additional enhancements to market transparency.[13]

Although SIFMA believes today's markets are strong, there are areas which merit improvement. Market transparency continues to increase for institutional market participants, but SIFMA remains concerned about the disparate level of transparency afforded retail investors. While decimalization has reduced spreads to the benefit of all investors, it has, not surprisingly, led to decreased size at the national best bid and offer ("NBBO"). Institutional investors are more apt to have technology that allows them to aggregate size at a rapidly changing NBBO or to access

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[9] *See, e.g.*, *id.* at 3600; *see also* O'Hara, Maureen and Mao Ye, *Is Market Fragmentation Harming Market Quality?* (Mar. 2009), 3-4, *available at* http://ssm.com/abstract=1356839 (discussing findings that market fragmentation does not appear to harm market quality).

[10] NYSE executed approximately 79.1 percent of the consolidated share volume in its listed stocks in January 2005, compared to 25.1 percent in October 2009. Concept Release at 3595.

[11] Angel, James J., Lawrence E. Harris, Chester S. Spatt, *The Economics of Trading in the 21st Century* (Feb. 23, 2010), 5, *available at* http://www.knight.com/newsRoom/pdfs/EquityTradinginthe21stCentury.pdf.

[12] *See* O'Hara at 19, *supra* note 9; Concept Release at 3605, fn. 60.

[13] Additional information about the trading activity of alternative trading systems ("ATS"), if adopted, will add to the strength and efficiency of our equity markets. *See* Exchange Act Rel. No. 60997 (Nov. 13, 2009), 74 Fed. Reg. 61208 (Nov. 23, 2009) (proposing regulation regarding non-public trading interest). However, as noted in our comment letter on that proposal, we believe the Commission can achieve its ATS transparency goals without risking harmful disclosure of confidential customer information through delayed, rather than real-time, reporting of ATS identity on trade reports. *See* Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC, Feb. 18, 2010 (advocating delayed ATS trade reports to avoid harmful disclosure of confidential investor trading interest). The SEC has approved new FINRA reporting requirements that reduce OTC trade reporting time from 90 to 30 seconds, which should improve market transparency in the near term. *See* Exchange Act Rel. No. 61819 (Mar. 31, 2010); 75 Fed. Reg. 17806 (Apr. 7, 2010).

individual market data feeds that show depth beyond the NBBO, but these tools and private data feeds are available to retail investors to a much lesser extent. This is especially problematic as US investors increasingly are managing their own portfolios, including investments for their retirement or their children's educational needs. Therefore, it is becoming more important that all investors have access to quality market data at reasonable prices. In addition, as exchanges have become for-profit entities, it becomes critical that the Commission take steps to support technology benefits for all investors, particularly with respect to access to enhanced market data. We discuss market data issues in greater detail in Section III.D of this letter.

As noted, SIFMA generally believes that our equity markets are effective and robust. However, in addition to the concerns expressed immediately above, we recognize that certain market practices have raised market efficacy or fairness concerns that need to be evaluated and, based on the results of that evaluation, perhaps addressed. We discuss certain of these issues below.

II. Current Market Structure Issues

A. High Frequency Trading and Related Issues

HFT is an example of technological and financial innovation that has generated both praise and strong criticism. We note that a variety of market participants employ HFT, ranging from those engaged solely in proprietary trading (whether as a proprietary trading firm that may or may not be a registered broker-dealer, a proprietary trading desk of a multiservice broker-dealer, or a hedge fund)[14] to broker-dealers that handle customer orders. HFT is a type of *trading*, not a type of *trader* – a distinction important to keep in mind when considering the various trading practices and tools often utilized in HFT. Not all market participants within a particular category (i.e., hedge funds, proprietary trading broker-dealers, etc.) engage in HFT, and therefore any regulatory initiatives designed to address issues raised by HFT should be targeted to the type of activity, rather than to the market participant, in order to achieve their objectives without unintended consequences.

HFT provides significant liquidity to investors, including long-term investors. Passive market-making trading strategies of HFT traders, for example, generally involve the submission of nonmarketable resting orders that provide liquidity at specified prices.[15] As the Commission notes, HFT traders largely have replaced more traditional types of liquidity providers in the equity markets, such as exchange specialists and OTC market makers.[16] To the extent that HFT orders – a significant portion of the overall number of orders in the market – establish or supplement the NBBO, they not only facilitate the trading objectives of HFT traders, but also serve as a reference point for executions by other market participants. Moreover, certain strategies associated with HFT, such as arbitrage strategies, help bring such prices in line by identifying and capitalizing on disparities between related financial instruments in different

[14] Concept Release at 3606.

[15] *Id.* at 3607.

[16] *Id.*

markets – thereby facilitating pricing efficiency. More generally, HFT is representative of technological advancements and broader changes in the provision of liquidity in the market – for instance, the migration from the single specialist system to the use of automated Designated Market Makers and Supplemental Liquidity Providers on the NYSE in recent years – changes that, in our view, have improved the equity markets.[17] HFT also has enhanced competition among markets. US exchanges and market participants – as well as foreign exchanges – have recognized these benefits and modified their trading infrastructures to accommodate HFT.[18]

However, as HFT has increased, issues have arisen regarding the fairness of HFT and whether such trading imposes an unreasonable amount of systemic risk on the equity markets. As discussed below, SIFMA believes there is a need for more disclosure about HFT and related issues. Such disclosure not only would provide market participants with more information related to an important market practice, but also would facilitate the Commission's efforts to appropriately regulate the markets. Similarly, we support the Commission's goal of enhancing risk controls related to market access, including HFT, although, as discussed below, significant issues need to be addressed with respect to proposed Rule 15c3-5.

1. Co-Location, Individual Data Feeds, and HFT Trading Strategies

a) Co-Location Arrangements

Co-location arrangements involve the hosting of servers by an exchange, trading center, or third party in close proximity to the matching engine of the exchange or trading center with the goal of minimizing network latencies in the transmission and execution of orders. Market participants that are confident in the efficiency of communication technologies and execution facilities are likely to be more comfortable, from a market risk perspective, with submitting greater numbers of orders, in larger size and over a larger universe of stocks, than they might under less optimal conditions. To this extent, co-location arrangements benefit all investors. However, concerns have been raised that the ability of some firms to utilize co-location arrangements is fundamentally unfair to other market participants. Questions also have been posed regarding whether firms using co-location arrangements ought to be subject to regulatory obligations similar to those formerly attendant on specialists and market makers. Related issues include whether the speed at which participants are permitted to access the markets should be controlled in a manner that provides more uniformity among market participants.

As an initial matter, SIFMA notes and agrees with statements in the Concept Release that exchange co-location arrangements are and should be subject to the rule filing requirements of

[17] *See* Exchange Act Rel. No. 58184 (Jul. 17, 2008), 73 Fed. Reg. 42853 (Jul. 23, 2008) (creating the NYSE's New Market Model, including the creation of Designated Market Makers and the phasing out of the NYSE specialist); Exchange Act Rel. No. 58877 (Oct. 29, 2008), 73 Fed. Reg. 65904 (Nov. 5, 2008) (establishing the NYSE Supplemental Liquidity Provider Pilot).

[18] *See, e.g.*, Nina Mehta, High-Frequency Trading Is a Tough Game, Traders Magazine Online News, Nov. 24, 2009; *see also,* LSE Changes Tariffs for High Frequency Trading to Boost Volumes, Bloomberg Network (Apr. 22, 2010) (LSE noting that the changes are "....designed to encourage tighter spreads, greater depth of liquidity and improved execution likelihood on the order book to the benefit of all participants.").

Section 19(b) of the Exchange Act, including the requirement that such proposed arrangements must be determined by the Commission to be consistent with the Exchange Act before being approved.[19] Provided that co-location facilities are made available to exchange members and other persons using those facilities on fair and reasonable terms, including physical location within a facility, and pursuant to fees that are equitably allocated among members and other persons using those facilities, we do not view co-location arrangements as conferring an "unfair advantage" to firms that use them or as creating a "two-tiered" market.[20] Exchange members that have the capability and desire to enter into co-location arrangements pursuant to exchange rules that have been reviewed and approved by the SEC under the Exchange Act should be permitted to do so.

We do, however, believe that added disclosure about co-location and other market access arrangements would be beneficial to market participants. Such disclosure might describe standard, high speed, co-location, or other means by which members may access an exchange or ATS, and provide market participants with details regarding the categories of market participants that use each means of access, the data capacity associated with each arrangement, and the quotation and transaction volume attributable to each arrangement. For example, the Commission could create greater transparency surrounding co-location arrangements by requiring exchanges that offer co-location services to disclose the number of market participants using co-location, the percentage of the exchange's orders, quotes, or executed transactions associated with co-location, and a general description of the activity of co-location users (i.e., number of messages per second, percentage of time at the NBBO, and activity in various tiers of securities).

We do not believe, however, that firms engaging in co-location arrangements should have affirmative or negative obligations solely as a result of such arrangements. Co-location arrangements are unlike exchange specialist status (where, as the SEC remarks, specialists enjoyed unique time and space advantages on exchange floors[21]) because they should be available to any firm willing to devote resources to entering into such an arrangement. Thus, we do not believe that participants in these arrangements should be required to accept affirmative or negative trading obligations.

b) Direct Data Feeds and the Processing of Market Data

Concerns also have been raised regarding whether it is fair that some market participants are able to use individual or direct market data feeds. Related questions include whether there should be "batch processing" or other measures to throttle the transmission of data in the markets in an attempt to level the playing field for data consumers, or whether data feeds should continue to disseminate as much information as is currently available.

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[19] *See* Concept Release at 3610.

[20] Exchange Act Section 6(a)(4), 15 USC § 78f(a)(4).

[21] Concept Release at 3611.

Restrictions on the availability of market data or the content and transmission speed of such data would be a significant step back for our markets. As recently as the adoption of Regulation NMS, the Commission acknowledged the utility that direct market data feeds provide to firms and investors in terms of providing prompt and, in many instances, more fulsome information about potential trading liquidity in a given market.[22] SIFMA believes that firms should continue to be able to use these direct market data feeds without any mandated delay to permit consolidated data to reach all users at the same time. Such a delay would slow the market to the transmission capabilities of a single plan processor and thereby reduce incentives for technological development, rather than encourage plan processors to update their systems to remain competitive in the markets. Batch processing of orders would exacerbate this problem by basing data transmission speed on the capabilities of an even larger universe of market participants.[23] Slowing the flow of market information would impede price discovery and reduce the pricing efficiencies that we currently enjoy among markets. We believe slower markets also would present greater opportunities for gaming. Rather than considering an approach that would slow technology or progress, the Commission should consider approaches that make direct market data feeds available to a broader universe of market participants, including retail investors, on fair and reasonable terms, and that enhance the speed and content of consolidated market data. We discuss our views on this issue in Section III.D of this letter.

It may, however, be appropriate for the Commission to give greater consideration to the manner in which direct market data feeds may be used by market participants. As noted, direct market data often is faster and more detailed than consolidated data. Also, direct data feed recipients generally are able to more easily trace orders they submit to an exchange or electronic communications network ("ECN") using such feeds – facilitating, for example, their ability to analyze the implications of a particular trading strategy. But some SIFMA members believe that direct market data feeds may be used by third parties to generate more implicit information about the markets. For example, member firms state that direct market transaction information may be linked to particular displayed quotations and, in some instances, direct market data may be used to help discern the presence of reserve orders. As discussed below, SIFMA does not believe that the use of trading strategies used to identify potential liquidity in various markets, whether displayed or undisplayed, necessarily requires a regulatory response. However, it might be beneficial for market participants to have a better understanding of the ways in which their market data, if provided to a trading center publishing direct market data, might be used by other

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[22] *See* Exchange Act Rel. No. 51808 (Jun. 9, 2005), 70 Fed. Reg. 37496, 37566-67 (Jun. 29, 2005) (authorizing the independent distribution of market data outside of what is required by the joint industry market data plans).

[23] Ironically, the Concept Release itself presents a compelling argument against restraints on communications technology. According to the release, the average speed of execution for small, marketable orders on the NYSE was 10.1 seconds in 2005, compared to 0.7 seconds in October 2009. Concept Release at 3595-96. Had the Commission adopted an approach similar to the batch processing idea discussed in the Concept Release, execution speeds on the NYSE not only would have been less likely to have decreased, but also other markets presumably would have seen their execution speeds constrained based on the capabilities of the NYSE or other markets. It is difficult to understand the incentive any market would have to improve on such speeds under such an approach.

market participants. We urge the Commission to give further thought to this issue, including whether it merits an empirical review.

c) Trading Strategies

The SEC raises a number of questions regarding HFT trading strategies, including whether the implementation of particular strategies benefits or harms long-term investors and, if so, whether regulatory initiatives are necessary to address such strategies. For example, the Commission asks whether it should impose a minimum requirement on the duration of orders (such as one second) before they can be cancelled, either generally, in particular contexts, or when used by particular types of traders, or whether the use of "pinging" orders by all or some traders to assess undisplayed liquidity should be prohibited or restricted in all or some contexts.[24] We think any such attempts are ill-advised.

We caution the Commission against hastening to categorize trading strategies as "beneficial" or "harmful." In the first instance, absent clear fraud or manipulation, we believe that engaging in such line drawing on a broad basis is fraught with difficulties. For example, market participants have long been astute to the possibility of other orders in the market that, if executed, could have a serious impact on the value of their portfolios. Thus, strategies designed to anticipate the trading of other market participants are not novel concepts, and the ability to identify buyers and sellers in the market – absent fraud, manipulation, or a breach of duty – should not result in prohibitions on a strategy that aims to make such determinations. In addition, existing trading strategies, whether for HFT or otherwise, will evolve in ways that inevitably will outpace regulatory efforts to categorize them, and entirely new trading strategies similarly will develop at a rapid pace.

Rather than taking a path that will require it to engage in such line drawing, the Commission would better serve investors by: (1) relying on its general antifraud authority to address discrete situations in which market participants engage in fraudulent or manipulative activity, and (2) adopting rules that would facilitate the provision of more information about HFT strategies to the Commission. The Commission would, of course, have to consider the extent to which such disclosure might lead to information leakage or otherwise disadvantage market participants, and take appropriate steps to avoid such adverse consequences (such as requiring the disclosure for regulatory and not public consumption, or publishing information in aggregated rather than disaggregated form). In this regard, SIFMA looks forward to reviewing and commenting separately on the Commission's proposal for large trader reporting.[25]

SIFMA is leery of regulatory efforts that may overemphasize real or perceived distinctions between the interests of "long-term investors" and "short-term professional traders." Admittedly, investors have different time horizons in terms of their investment objectives. For

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[24] Concept Release at 3607.

[25] *See* Exchange Act Rel. No. 61908 (Apr. 14, 2010), 75 Fed. Reg. 21456 (Apr. 23, 2010) ("Large Trader Reporting Release").

example, an investor with a long time horizon generally is likely to be less concerned with short-term volatility in a stock, whereas an investor with a short time horizon is apt to be more concerned about short-term price movements than the long-term performance of that stock. However, we believe that the interests of long-term investors and professional traders are, in fact, aligned more often than might be assumed and, where they differ, as described above, the nature of each investor's trading interest is not necessarily incompatible with the other. For example, the ability of a long-term investor to purchase or sell a security is dependent on available market liquidity, whether provided by long-term or short-term investors. As noted by the Commission itself, much of the liquidity in today's market – available to professional traders and long-term investors alike – is attributable to professional traders.

2. Risk Management – Market Access

SIFMA recognizes that the volume and rate of message traffic associated with HFT may pose enhanced financial, regulatory, and other risks to broker-dealers and trading markets. Therefore, as a general matter, we support the use of pre- and post-trade controls on market access, and the general principle underlying the SEC's proposed Rule 15c3-5 that such controls and procedures are appropriate in market access arrangements. However, if proposed Rule 15c3-5 is to be effective, certain significant, complex issues regarding market access must be addressed before the SEC adopts the rule.

As discussed in greater detail in SIFMA's separate comment letter regarding the proposed rule,[26] we believe that proposed Rule 15c3-5 does not appropriately distinguish market access arrangements involving multiple broker-dealers, each of which undertakes a different role in a transaction. In certain circumstances, the broker-dealer providing market access may not be in the best position to control financial and regulatory risks associated with the relevant transactions, or financial and regulatory controls may already be assumed by other broker-dealers involved in the transaction. For example, an introducing broker-dealer may route its customer orders to an exchange through a broker-dealer that provides it access, and may clear those orders through a separate clearing broker. The SEC also should clarify that nothing in proposed Rule 15c3-5 precludes the continued application of self-regulatory organization ("SRO") guidance that requires broker-dealers to apply risk controls and procedures to orders that are sent to non-exchange and non-ATS trading venues or to internal ATS venues.

In addition, because many broker-dealers rely on third-party risk management technology, the SEC should clarify that a third-party vendor may control the underlying software of such risk management technology, so long as the broker-dealer is able to control the software's applied

[26] *See* Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth M. Murphy, Secretary, SEC (Apr. 16, 2010) (regarding risk management controls for broker-dealers with market access). SIFMA's comment letter also asks the SEC to clarify certain issues regarding capital and credit thresholds required under the proposed rule, how broker-dealers can comply with the proposed CEO certification requirement, and that the SEC and SROs should examine firms with a view to improving procedures rather than treating any trading error as a violation of the rule per se, as well as to recognize in any adopting release the difficulty of and limits involved in monitoring for duplicate orders.

parameters and thresholds. The SEC also should clarify that such permitted third-party software includes that provided by exchanges and ATSs,[27] given that market centers currently do and should continue to play a significant role in monitoring risk management compliance. Market centers are particularly well suited to apply certain pre-trade controls to order flow, such as trading halts, clearly erroneous orders, and orders not reasonably related to the market.

SIFMA also is concerned that the rule as proposed could be interpreted to require a firm providing market access to have access controls and procedures reasonably designed to prevent the entry of orders that are manipulative or based on inside information. The SEC should clarify that broker-dealers providing market access would not be liable for regulatory requirements only tangentially related to market access, such as margin, or violative behavior such as manipulative trading, insider trading, or other fraudulent activity.

B. Undisplayed Liquidity

The terms "undisplayed" or "non-displayed" liquidity are used to encompass a wide variety of trading interest. Non-displayed trading interest includes some exchange and ECN orders (including exchanges and ECNs that permit members or subscribers to limit the display of some or all of the quantity of an order), ATS orders (ATSs accept orders that are not displayed to subscribers or non-subscribers), working orders of buy side or institutional investors, and working orders and capital commitment trades of broker-dealers. Displayed liquidity, on the other hand, includes the consolidated quote and the NBBO, quotes on the Alternative Display Facility ("ADF"), and depth of book data offered by certain market data vendors or exchanges and ECNs that shows all of a market center's bids and offers.[28] As the SEC is aware, non-displayed liquidity venues often are used by market participants seeking to avoid adverse market impact when executing their trades.

SIFMA does not believe the evidence demonstrates that the availability of non-displayed liquidity venues has, in fact, impaired price discovery or execution quality. To the contrary, as described above, display markets remain healthy. We note, for instance, the prevalence of very narrow spreads in NMS stocks, indicating that effective and efficient price discovery is occurring in the public markets.[29] In addition, by protecting the top of book of trading centers, the OPR is an effective supplement to the duty of best execution in policing execution quality. Such studies also indicate there have been improvements in depth of book display beyond the NBBO.[30]

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[27] For example, the NYSE's Risk Management Gateway, *at* http://www.nyse.com/technologies/tradingsolutions/1227870669701.html.

[28] *See* SIFMA paper on Displayed and Non-Displayed Liquidity, Aug. 31, 2009, at www.sifma.org.

[29] *See* O'Hara at 19, *supra* note 9 ("In the post-Reg NMS world, effective spreads are extremely low, with average spreads in the 3-4 cent range. Turning to our specific hypothesis, the data show that effective spreads are lower in the fragmented sample on average by .29 cents with median spreads lower by .11 cents.").

[30] *See* Angel at 15, *supra* note 11. Notwithstanding these research findings, as discussed herein, SIFMA believes that steps can and should be taken to extend the benefits of enhanced market data to retail investors at a reasonable cost.

These trends have occurred concurrent with the growth of ATSs – which have offered significant opportunities for price improvement to their end users, including firms representing retail investors – as a percentage of all non-displaying liquidity venues. We note that some market participants have identified recent empirical evidence suggesting a possible migration trend in execution volumes from displayed to non-displayed markets,[31] but that the most recent studies we have seen do not discuss any adverse market impact resulting from this trend. We note also that, given the changes in the markets as a result of non-displayed liquidity, there is no current evidence to suggest that non-displayed liquidity would become displayed liquidity should the use of non-displaying trading venues be restricted. Nevertheless, we encourage the SEC to conduct its own study on whether these observations are representative of longer term material changes, and, if so, whether they have a detrimental impact on market quality.

C. Trade-At Proposal

The Concept Release asks whether, if commenters believe that the quality of public price discovery has been harmed by non-displayed liquidity, the Commission should consider a "trade-at" rule. Such a rule would prohibit any trading center from executing a trade at the NBBO unless the trading center was displaying that price at the time it received the incoming contra-side order. The trade-at rule would require a trading center not displaying at the NBBO at the time it received an incoming marketable order either to execute the order with significant price improvement (e.g., the minimum allowable quoting increment), or route intermarket sweep orders ("ISOs") to the full displayed size of NBBO quotations and then execute the balance of the order at the NBBO price.[32]

SIFMA strongly opposes the concept of a trade-at rule. Initially, and in response to the Commission's threshold question, such a rule is not warranted given the health of our markets (described above) and, importantly, the absence of compelling evidence that non-displaying trading venues are impairing public price discovery. A trade-at rule would likely lead to a deluge of additional message traffic and increased incidence of flickering quotes. The added costs to trading centers and broker-dealers would likely be significant and it is not clear that the anticipated benefits of additional quotes at the inside would outweigh them.

We also believe that a trade-at rule would have significant adverse consequences for investors, and retail investors in particular. Competition with respect to other best execution factors – such as market depth, reliability, and liquidity guarantees – would fall largely by the wayside under a trade-at rule that effectively dictates the manner in which broker-dealers must trade. For

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[31] *See, e.g.*, Rosenblatt Securities Inc., *Trading Talk: Market Structure Analysis & Trading Strategy – Let There Be Light* (Apr. 27, 2010) (indicating that non-displayed trading volume has increased while displayed trading volume has decreased during February and March, 2010); *compare* Erik Sirri, Keynote Speech at SIFMA 2008 Dark Pools Symposium (Feb. 1, 2008), at http://www.sec.gov/news/speech/2008/spch020108ers.htm ("The bottom line is that the volume percentage of dark pools of liquidity operated by dark ATSs and broker-dealer internalizers has remained [the same]...").

[32] Concept Release at 3613.

example, broker-dealers executing orders internally currently may provide a customer with faster executions along with opportunities for price improvement. By contrast, a trade-at rule might instead require that same order to be routed out, both slowing the execution of the customer's order and, potentially, causing the customer to miss the market and lose the opportunity for price improvement. In addition, a broker-dealer routing an order to an away trading center may well incur additional costs in the form of fees for accessing the liquidity of the away market. These fees, ultimately, may be passed on to customers. Price competition among trading centers would be significantly hindered by a trade-at rule. A trade-at rule would require certain quotes to be hit in various trading centers, which in turn would reduce the incentive for trading centers to provide lower cost executions by, for example, lowering access fees.

More fundamentally, a trade-at rule would stifle innovation, making it less feasible for new business models that have been introduced into the markets during the last decade to exist, to the detriment of all investors. For example, the rule would significantly impact the ability of investors, including long-term investors, to use non-displaying trading venues to handle sensitive order flow. The requirement that such a trading venue offer price improvement at least in the amount of the minimum increment to execute orders when the operator of the venue is not quoting at the NBBO would be difficult to meet given that many stocks trade in penny increments. Alternatively, the routing of ISOs to the full displayed size of NBBO quotations would subject such venues to access fees in away markets and significantly reduce the ability of non-displaying venues to offset customer orders.

Routing under a trade-at rule also might increase the chance of information leakage, signaling to other market participants the possibility of additional order flow at the non-displaying trading venue, thereby disrupting attempts of institutional investors to reduce implicit costs associated with large orders. While order routing is required in some circumstances under the OPR, the risk of information leakage is ameliorated somewhat by the promotion of the regulatory policy of not allowing a *better* priced limit order to be bypassed, and thus the fact that the routed order receives a *better* price as a result of the routing. In addition, investors who prefer not to have their orders displayed or routed could miss execution opportunities should potential contra-side liquidity have to be routed away to comply with a trade-at rule.

In sum, a trade-at rule would have detrimental effects on the speed and cost of executions, the liquidity currently available in the market, and the ability of investors to control their trading interests. It would undercut best execution by dictating a particular manner of trading, which we think is unnecessary given the recent performance of the equity markets. In doing so, the rule would extend well beyond even the OPR in its clear preference of investors who display orders over investors who decide it is in their best interest not to display some or any of their orders – even if they may be willing to execute at the same price as the displayed markets. In this respect, a trade-at rule comes very close to a consolidated limit order book or "CLOB." Both would negate the competitive benefits of dispersed order flow and unnecessarily impede investor

choice. We note that the SEC has considered a trade-at rule or CLOB in the past and determined that such restrictive trading measures were unnecessary.[33]

D. Potential for Sub-Penny Pricing

Noting that a penny spread on a low-priced stock provides a greater incentive for internalization, the Commission asks whether it should consider reducing the minimum trading increment under Rule 612 for low-priced stocks. Currently, Rule 612 precludes exchanges, associations, ATSs, and broker-dealers from displaying, ranking, or accepting bids, offers, or orders in NMS stocks in prices less than a penny if the bid, offer, or order is priced equal to or greater than one dollar per share. Conversely, market participants may display, rank, or accept bids, offers, or orders priced less than one dollar per share in increments as small as $0.0001.

SIFMA continues to believe that quoting in sub-penny increments would not contribute to the maintenance of orderly markets. Sub-penny pricing would encourage market participants to "step ahead" of competing limit orders by submitting an order with an economically insignificant price enhancement to gain execution priority. Currently, in order to step ahead of a competing limit order, a market participant needs to post an order for 100 shares at a full penny better than the existing order. This offers a full dollar of price improvement to the putative liquidity taker of a round lot and provides meaningful economic value in order to achieve price priority for incoming market orders. If sub-penny quoting were permitted, for example, such that an order could step ahead based on a price only .001 higher than a competing order, the resulting price improvement would be only ten cents. SIFMA believes that attaining priority for such a low amount would reduce the incentive for liquidity providers to publish limit orders. It also would negatively impact the utility of order priority rules such as the OPR. Increasing the number of pricing points at which market participants may trade and, as a related matter, reducing the costs associated with gaining price priority to a level that is not meaningful predictably will lead to even greater amounts of orders and flickering quotes in today's automated trading environment. Sub-penny pricing also would decrease the depth available at the best displayed prices, rendering the NBBO less effective in reflecting true trading interest. Decreased depth at each price in turn would require multiple transactions at multiple prices to complete an order, which would increase the cost and difficulty of completing a trade.

In addition, sub-penny pricing would pose both operational risks and technological challenges. The ability of firms to enter prices to three or more decimal places increases the likelihood of human error with very little pricing advantage gained, creating additional operational risk. We also assume that sub-penny pricing would be permitted, if at all, for a subset of securities determined by price, volume, available liquidity, or other factors. Permitting a greater degree of sub-penny quotations for such a subset of securities and taking into account these various and potentially variable factors would require significant systems recoding, increasing both operational risk and cost for all market participants without providing commensurate significant price improvement. The proliferation of quotes also would create systems capacity problems – for instance, it would be difficult to view and keep track of quotes if the number of quotes

[33] *See* Market Fragmentation Release at 10587-88.

available in a given stock increased by a factor of ten. SIFMA notes that, in the options markets, for example, the data rates increased so significantly in the options penny pilot that options exchanges needed to develop quote mitigation strategies to limit the amount of data generated.[34]

Sub-penny pricing also has implications in light of the existing "maker-taker" fee structures of various markets, discussed below. Sub-penny pricing would be particularly problematic in the event market participants were to earn maker-taker rebates in excess of the spread for a stock. Such a fee structure could incentivize market participants to aggressively place orders in expectation of collecting a rebate without regard to the quality of the execution received. Thus, should the Commission consider sub-penny pricing for stocks priced higher than one dollar, it also needs to consider access fees and maker-taker rebate incentives and their potential effect on rebate arbitrage and execution quality.

E. Maker-Taker Pricing/Rebates, Access Fees, and Liquidity Fees

Some SIFMA members have expressed concern that market pricing models and rebates have had a significant impact on market structure and should be studied further by the Commission. For example, concerns have been raised that "maker-taker" pricing subsidizes professional traders using co-location and direct data feeds at the expense of retail and long-term investors. It appears that the bulk of the maker-taker rebates for adding liquidity are paid to firms engaged in HFT. A high rebate often implies a higher taker charge,[35] which is in turn paid by long-term investors either directly, or indirectly through increased costs on their executing broker-dealers that, ultimately, are passed through to them. Maker-taker pricing also has been said to distort economic spreads. For instance, for stocks trading in penny increments, a taker fee can represent up to a 50-60 percent mark-up from displayed prices. As a result, broker-dealers increasingly spend significant resources analyzing the impact of taker fees on execution quality. In order to allow for an objective assessment of this and related issues, SIFMA believes the Commission should conduct a study regarding the impact of maker-taker pricing on order routing, execution practices, and market quality.[36]

The Concept Release notes that retail order flow typically is sent to OTC market makers pursuant to payment for order flow ("PFOF") arrangements.[37] SIFMA does not believe that PFOF arrangements are the primary drivers of routing decisions; instead, we believe that routing

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[34] *See, e.g.*, Max Bowie, Is Sub-Penny Pricing Just Common Cents? (Feb. 1, 2010). *See also* Exchange Act Rel. No. 55162 (Jan. 24, 2007), 72 Fed. Reg. 4738 (Feb. 1, 2007) (approving proposed changes to AMEX rules regarding the option penny pilot, including a quote mitigation proposal); Exchange Act Rel. No. 55156 (Jan. 23, 2007), 72 Fed. Reg. 4759 (Feb. 1, 2007) (approving proposed changes to NYSE Arca rules regarding the option penny pilot, including a quote mitigation proposal).

[35] However, as the Commission notes, a trading center may have an inverted pricing structure, paying a liquidity rebate that is higher than its access fee. Concept Release at 3599.

[36] As part of this study, the Commission might consider a pilot program that would consist of stocks across varying price levels that could be traded only without the provision of rebates to determine the impact liquidity rebates may have on order routing, execution practices, and market quality.

[37] Concept Release at 3606.

decisions more often are based on the OPR and other factors associated with particular trading venues, such as rebates and access fees. We also note that OTC market makers often are able to offer price improvement to small orders. That said, SIFMA recognizes that the total amount of PFOF paid to firms per year is not immaterial, and that it may make sense for the Commission to study whether such arrangements have had an impact on execution quality for investors.

F. Market Quality and Order Routing Data: Rules 605 and 606

The Commission has asked whether Rules 605 and 606 continue to provide useful information regarding the quality of order execution by market centers[38] and the routing of customer orders by broker-dealers, or whether these Rules need to be modified given changes in the markets since their adoption. More specifically, the Commission asks whether individual investors understand and pay attention to Rule 605 and Rule 606 statistics.[39] SIFMA believes that, in their current form, neither of these rules provides useful and meaningful comparative information to market participants, particularly individual investors, or regulators, and that the rules should be either modified or rescinded in light of market developments.

Rule 605 was adopted to improve public disclosure of the quality of executions afforded to orders by market centers.[40] The Rule requires monthly reports by market centers that include information about a market center's quality of executions on a stock-by-stock basis, including, among other statistics, how market orders of various sizes are executed relative to the public quotes, as well as information about effective spreads (the spreads actually paid by investors whose orders are routed to a particular market center). The Rule also requires market centers to disclose the extent to which they provide executions at prices better and worse than the NBBO to investors using limit orders.

One element of Rule 605 that should be amended is the timeframe by which execution quality is measured. Currently, Rule 605 reports require disclosure of execution time in tranches measured in whole seconds. In the current equity markets, in which executions occur in milliseconds if not microseconds, whole second execution quality measures do not provide useful information regarding execution speed. For instance, we understand that the Rule 605 reports of some market centers list their execution speed as "zero seconds" while others list execution speed at one second due to rounding for purposes of the Rule. Therefore, Rule 605 should be amended to take into account today's sub-second execution speeds in order to provide useful execution quality information.

Similarly, benchmarking under Rule 605 has become more complicated in recent years. Industry vendors conducting Rule 605 analyses typically base their benchmark on consolidated market

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[38] Exchange Act Rule 600(b)(38) defines a market center as an exchange market maker, OTC market maker, ATS, national securities exchange, or national securities association. 17 C.F.R. §240.603(c).

[39] Concept Release at 3605-06.

[40] *See* Exchange Act Rel. No. 43590 (Nov. 17, 2000), 65 Fed. Reg. 75414 (Dec. 1, 2000) ("605 and 606 Adopting Release") (adopting Rules 11Ac1-5 and 11Ac1-6, renumbered pursuant to Regulation NMS as Rules 605 and 606, respectively).

("SIP") data, whereas broker-dealers submitting execution data, including time, often use direct market data that does not have the same latency as the SIP data. The Rule 605 vendors then compare the data provided by broker-dealers with the SIP data, resulting in information likely to be inconsistent. As a result, Rule 605 should have data parameters in place to ensure more uniform benchmarking and analyses.

In addition, SIFMA is concerned about the possible disparate treatment of marketable orders in displaying and non-displaying trading venues for Rule 605 purposes. We recognize that the Commission has issued guidance regarding what constitutes a "covered order" for purposes of Rule 605 reporting, and with respect to the exclusion from Rule 605 of special handling orders, in particular.[41] However, we think there may be some confusion among broker-dealers regarding whether or not resting orders routed to non-displaying trading venues must be included in Rule 605 reports.[42] As a result, Rule 605 data may not reflect consistency in the treatment of covered orders. The Commission should consider providing additional guidance on what constitutes a covered order that takes into account changes in trading practices to promote more consistent Rule 605 data.

Similarly, there appears to be confusion among market participants about how certain types of orders should be treated for Rule 605 purposes – for instance, whether all orders in securities in which a broker-dealer makes a market should be reported (regardless of whether the broker-dealer acted as a market maker in the specific transaction reported), whether both proprietary and customer orders should be reported, or whether, for large size orders, only "parent" or both "parent" and "child" orders should be reported. Therefore, Rule 605 should be modified to clarify the types of orders that are within its ambit to ensure that Rule 605 requirements are clear to market participants and that Rule 605 data is consistent and useful to routing broker-dealers and investors. Also, as noted above, market access fees have become a significant focus in order routing determinations. SIFMA believes that statistics regarding access fees and liquidity rebates would be useful as part of Rule 605 disclosures.

To the extent the SEC believes Rule 605 data, as modified to address the issues noted above, provides useful information regarding order execution quality, the data might be presented in a form that is more meaningful to investors. While we are cognizant that a primary purpose of Rule 605 data is to facilitate order routing determinations by broker-dealers, investors increasingly have more input into routing decisions – whether via sponsored access arrangements or otherwise. A more "user friendly" format for execution quality statistics would be helpful not

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[41] *See, e.g.*, 605 and 606 Adopting Release at 75421-22; SEC Division of Market Regulation: Staff Legal Bulletin No. 12R *(Revised)*: "Frequently Asked Questions About Rule 11Ac1-5," FAQ 5, *available at* http://www.sec.gov/interps/legal/slbim12a.htm (explaining that "[t]he definition of covered order in paragraph (a)(8) of the Rule does not specifically identify every type of order that may fall within the "special handling" exclusion. In general, any market or limit order for which the customer requests a type of handling that may preclude the order from being executed promptly at the current market price at the time of order receipt (subject only to a limit price) would qualify for the special handling exclusion and not be covered by the Rule.").

[42] For instance, depending on the availability of contra-side orders in a non-displaying trading venue, marketable orders in such trading venues may not be executed for significant periods of time. Some firms have expressed uncertainty about whether such orders fall within the special handling exclusion.

only for institutional investors, but also would aid retail investors seeking to better understand the routing decisions of their broker-dealers.

Rule 606 was adopted to improve public disclosure of broker-dealer practices with respect to the routing of customer orders.[43] Rule 606 requires broker-dealers that route customer orders in equity and option securities to make publicly available quarterly reports that, among other things, identify the trading venues to which customer orders are routed for execution. In addition, broker-dealers are required to disclose to customers, on request, the venues to which their particular orders were routed. Finally, the rule requires broker-dealers to disclose the material aspects of their relationships with each executing venue, including any PFOF or profit-sharing arrangements.

As with Rule 605, SIFMA is concerned that Rule 606 statistics no longer provide meaningful information to investors about order routing decisions. The primary reason is that order routing practices now are largely driven by the OPR and the requirement to fill protected quotations. In addition, and unlike when Rule 606 was first adopted, there is now a significant amount of "pinging" activity using immediate-or-cancel ("IOC") orders. The practice of pinging makes it difficult for customers to discern when a broker-dealer has routed IOC orders to find potential liquidity from when customer limit orders are routed to post liquidity in a trading center. Although, as noted elsewhere in this letter, we do not believe pinging is detrimental to the markets, the changes in market routing practices renders Rule 606 inadequate for providing information to investors about actual order routing decisions. We do believe that there is value in disclosing broker-dealers' potential conflicts of interest regarding order routing, but such disclosure could be provided by means other than Rule 606 reports, such as through other disclosure on broker-dealer websites.

III. Suggested Regulatory Initiatives

SIFMA believes that, going forward, the equity markets should be characterized by the same underlying principles that have led to the development of the current NMS: the existence of multiple, competing markets; efficient and effective linkages; the availability of varying forms of market data; and continued technological and financial innovation. We note, however, that certain specific improvements to the current market structure will be necessary to maintain strong, efficient, and effective equity markets.

A. Consolidated Audit Trail and Large Trader Reporting

SIFMA understands that the Commission currently is considering the utility of a consolidated audit trail, and we respectfully urge the Commission to make this a regulatory priority in the near future. A consolidated audit trail would be a significant step in improving oversight of the markets. Although FINRA's Order Audit Trail System ("OATS"), the NYSE's Order Tracking System ("OTS"), and the ability of the Commission to seek Electronic Blue Sheets ("EBS") provide useful audit trail information, they do not provide regulators the benefits of a

[43] *See* 605 and 606 Adopting Release.

consolidated audit trail. An efficient, harmonized, and market-wide regulatory audit trail would eliminate redundancy among the various SRO audit trail and surveillance requirements and systems. It also would allow better oversight of the markets as a whole, thereby helping to reduce overall market risk.

In order to be effective, a consolidated audit trail should have a single system administrator and permit market participants to report order and transaction information once, which would improve reporting efficiency and provide the administrator a holistic view of market activity. This would allow regulators to better monitor market activity and address discrete regulatory issues. An effective consolidated audit trail would entail uniform reporting rules among SROs and mandatory information sharing among SROs to provide consistency and reporting efficiency.[44]

SIFMA intends to submit a separate comment letter on the SEC's large trader reporting proposal,[45] but believes that the proposal raises many of the issues discussed above regarding a consolidated audit trail and that these are worth raising, albeit briefly, in this letter. While SIFMA supports the concept of large trader reporting, we believe that the Commission's large trader reporting proposal should be part of the process of creating a consolidated audit trail, rather than a separate and preceding process that will shift regulatory focus and market participant resources away from a consolidated audit trail process. For example, we do not think it is productive to devote industry time and resources to what SIFMA believes will be a complicated and lengthy process of enhancing the EBS system and current EBS reporting to accommodate the proposed rule. Instead of undertaking this task, we believe it would be much more beneficial for the Commission and the industry to work toward the more critical goal of establishing the consolidated audit trail.

If the Commission believes that large trader reporting should be a near-term regulatory objective, SIFMA recommends alternative means of accomplishing that goal that will require less time and resource commitment and allow regulators and market participants to focus on the larger and more significant goal of developing a consolidated audit trail. For example, one option would be to require large traders to self-report currently, obtaining MPIDs or other identifying numbers in order to do so, which would provide the SEC with the information it needs without requiring the expensive and time-consuming enhancement of EBS. SIFMA continues to review the large trader reporting proposal and looks forward to providing more comments to the Commission in the near future.

B. Increased Harmonization of Disparate Regulation and Compliance Oversight

SIFMA believes that the current regulatory structure entails many conflicting or duplicative rules and regulations, regulatory initiatives, and systems programming demands. This places

[44] For example, we expect that such a consolidated audit trail would incorporate relevant Trade Reporting Facility ("TRF") reporting rules as well as the most effective elements of the OATS and OTS systems and the EBS system.

[45] *See* Large Trader Reporting Release.

unnecessary burdens on regulators and market participants alike, and poses a significant risk to market efficiency as well as meaningful investor protection. We recommend that the SEC, SROs, and other market participants undertake a comprehensive review of existing market structure and trading rules to identify conflicting or duplicative requirements that could be harmonized or eliminated.[46] Although we commend FINRA and the NYSE for their work on a consolidated rulebook for the past few years, we believe that there are several trading rules that could be harmonized to provide better market efficiency without compromising investor protection. For example, the harmonization of NYSE Rule 92 and FINRA's Manning Rule has been ongoing for several years, and SIFMA believes that a single rule in this area would be most effective and efficient. More generally, SIFMA believes that a single set of trading rules would be sufficient.

In addition, the Commission, SROs, and firms must find ways to better coordinate and streamline system programming demands associated with regulatory changes. For example, current programming demands facing market participants include FINRA's Related Market Center identifier, Nasdaq's sponsored access rule (as well as any other market access rules that are approved),[47] short sale regulation requirements, including the newly-adopted price test,[48] FINRA's OTC consolidated quote facility,[49] symbology changes,[50] and business-related programming requirements such as the DirectEdge exchanges, the Nasdaq OMX PSX exchange, and the BATS exchange, all of which are scheduled currently to go live in 2010. Systems changes have become increasingly complex, costly, and time consuming. Coordination among regulators and market participants with respect to technical specifications, implementation, and testing time periods would be a more rational and efficient approach to this urgent issue. Making coordination a higher priority would provide the Commission with a better sense of the capabilities of market participant systems and the sorts of programming changes feasible within reasonable time frames, which would enable it to better assess the programming demands of proposed SEC and SRO rulemaking. We emphasize that the primary concerns regarding such programming issues are capacity and the dedication of personnel necessary to systems

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[46] *See* Letter from Ira D. Hammerman, Senior Managing Director and General Counsel, SIFMA, to Christopher Cox, Chairman, SEC, Nov. 25, 2008 (regarding SEC guidance concerning proposed rule changes filed by SROs); Letter from Marc E. Lackritz, President, SIFMA, to Jonathan G. Katz, Secretary, SEC, Mar. 9, 2005 (regarding the SEC's SRO governance and transparency proposal and self-regulation concept release) (together, the "SRO Letters").

[47] Exchange Act Rel. No. 61345 (Jan. 13, 2010), 75 Fed. Reg. 3263 (Jan. 20, 2010).

[48] *See* fn. 2.

[49] Exchange Act Rel. No. 60999 (Nov. 13, 2009), 74 Fed. Reg. 61183 (Nov. 23, 2009).

[50] *See, e.g.*, Options Clearing Corporation Information Memo #26905 (Jan. 25, 2010) (describing changes to option contract adjustment methodology and symbol conventions to become effective with the implementation of the Options Symbology Initiative); NYSE/Euronext Information Memo (Nov. 4, 2009) (announcing NYSE AMEX's commencement of Nasdaq symbol trading and testing schedule); Nasdaq OMX Equity Trader Alert #2010-1 (Jan. 13, 2010) (notifying market participants of required changes to specifications regarding equity symbology in response to the NYSE's announced intention to begin listing and trading companies using 5-character root symbols.).

development and quality assurance to ensure that programming changes do not strain the capacity or functionality of the overall market structure.

SIFMA also believes the SEC should pursue greater global regulatory coordination. Given the vast array of regulatory and legislative initiatives in the US and other countries, it is critical that the collective impact of global economic growth be carefully considered, notwithstanding the merit of any individual measure. As SIFMA has previously stated, we are concerned about potential barriers to market entry, distortions to competition, and regulatory arbitrage that could result from the accelerated pace of regulatory and legislative reforms that are not considered together as part of a well-balanced and well-coordinated regulatory framework.[51]

C. Reliance on Empirical Data

SIFMA believes that investors, market participants, and the Commission would benefit from greater efforts to ensure that regulatory proposals are sufficiently grounded in supporting empirical data. This is particularly the case to the extent proposed regulations would reduce investor flexibility. Such data should be made publicly available so that market participants – including broker-dealers, investors, academics, and other interested parties – have the opportunity to review it and provide more fully informed responses to proposed regulations. Basing regulatory proposals on such data will help engender market confidence in any resulting final rules among market participants and investors alike. For example, before proposing significant changes to the manner of trading available in displayed and non-displayed markets, the SEC should offer empirical data evidencing the underlying bases for key regulatory concerns – namely, that public markets have been harmed by trading in non-displayed markets and that such harm outweighs the benefits offered to investors by non-displaying markets.[52]

As technology continues to evolve and impact market structure, increased use of empirical data will be critical to developing sound regulatory policymaking. In particular, the Commission's increased attention to the potentially different interests of long- and short-term investors requires greater clarity and evidence regarding where and how such interests, in fact, diverge. Where the Commission proposes to take regulatory action based on such differences, whether they be varying time horizons for investment gains or concerns about competitive advantages in the marketplace, such proposals should be rooted in data regarding a measurable difference that exists to the detriment of long-term investors, and balancing that interest against competing market interests.

Of course, we appreciate that the Commission typically solicits data from market participants and other commenters in the course of its rule proposals. However, the limited comment period associated with many of the Commission's proposed rules often is insufficient to assemble, assess, and provide data in timely comments. And, although empirical data provided in

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[51] *See* SIFMA Press Release, SIFMA, AFME, and ASIFMA Support G20 Work to Take Stock and Assess Global Reforms, Prevent Regulatory Fragmentation, Increase FSB Transparency (Nov. 6, 2009), at www.sifma.org.

[52] As discussed above, SIFMA does not believe there is sufficient empirical data regarding any negative market impact of non-displayed liquidity.

comments on the Commission's proposed rulemaking is useful, we think rulemaking would be more effective if the Commission were to conduct and publish more of its own empirical analysis before proposing rules. SIFMA notes that the Commission in the past has provided data to support its rule proposals, such as for Regulation NMS.[53] When such empirical analysis is conducted and data is made available by the Commission in support of its rulemaking, the subsequent discussion and analysis of the proposed rulemaking is more efficient and productive.

D. Market Data Issues

As a preliminary matter, SIFMA notes that retail investors, either acting in a self-directed manner or with the assistance of a financial adviser, must rely largely on consolidated market data when making investment decisions. This is not because retail investors do not want to see meaningful liquidity – rather, it is because depth of book market data pricing generally is too expensive for the majority of retail investors. As a result, we believe it is vital that the consolidated market data currently available in the markets be significantly enhanced both in terms of the speed at which data is updated and transmitted, and in terms of the amount of data currently available. As discussed elsewhere in this letter, SIFMA does not believe that slowing the rest of the market and direct data feeds to the pace of consolidated data is an appropriate solution to disparities between retail and institutional investors' access to market data. Rather, the Commission should take steps to require or incentivize improvement in consolidated market data speed and depth without sacrificing the improvements made regarding the speed and depth of direct market data.

In addition, SIFMA believes that there should be a reasonable relation between the costs associated with producing market data and the fees charged for that market data. We remain concerned about the lack of transparency in how such fees are determined.[54] We note, for example, that the Concept Release data indicates the consolidated tape revenue is 32 times greater than expenses, and that expenses appear to be static or decreasing.[55] With faster and improved technology, market data fees should be trending downwards, rather than upwards. We believe cost-based market data fees subject to a transparent fee-setting process would result in lower market data fees. Such a fee-setting process should involve market participants and permit real challenge to the market data fees being proposed. In addition, we do not believe that market data fee rule changes should be permitted to be effective upon filing, and should instead be subject to a full notice and comment process.

The Commission has stated in the past that it agrees that the level of market data fees should be reviewed and that, in particular, greater transparency concerning the costs of market data and the

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[53] Concept Release at 3604, fn. 55.

[54] *See* Letter from Marc E. Lackritz, President, SIA to Jonathan G. Katz, Secretary, SEC, Feb. 1, 2005 (regarding Regulation NMS); SRO Letters, *supra* note 46.

[55] Concept Release at 3601.

fee-setting process is needed.[56] Because these costs are passed on to the end-user investor in one form or another, it is the investor who stands to benefit from such increased transparency. We believe the Commission needs to address this issue in the near future in order to bring market data fees in line with the true costs of providing market data.

In order to achieve the market data goals discussed above, SIFMA believes that the SEC should facilitate greater competition regarding market data. One approach would be to establish a competing consolidator model for market data. Such a model would, for example, allow the individual SIPs to handle all symbols, and then permit each of them to compete on price and market data performance according to defined metrics established to ensure market data quality. A competing consolidator model would incentivize SIPs to provide public market data in the most cost effective way, and ensure market data quality by requiring SIPs to compete for market share. It might even encourage the entrance of a new SIP not controlled by the exchanges. Alternatively, the Commission could amend the so-called display rule that requires SIPs and broker-dealers to purchase and provide consolidated market data to their customers at the point of trade decision,[57] and instead, or as an alternative, permit individual broker-dealers to purchase direct data feeds from exchanges and consolidate the data themselves. Either approach would remove, in part, the government-mandated monopoly that each SIP enjoys today, putting pressure on the SIPs to improve their service, contain their costs, and begin to compete on price.

Should the SEC not establish a competing consolidator model or amend the display rule as noted above, at a minimum, it should require a more harmonized approach on market data rules and a single uniform agreement among tape associations to create a more efficient means of accessing public market data. Currently, the SIPs have differing regulatory and operational infrastructures that unnecessarily complicate market participants' access to their market data. For example, there is not a uniform market data agreement, so market data subscribers must use multiple and often differing agreements with market data providers. Such agreements may have multiple standards and definitions (e.g., what constitutes a "professional"), making coordination and compliance with the various standards difficult and time consuming in terms of personnel and back office support. This effort could be significantly streamlined with more uniformity among SIP requirements.

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[56] Exchange Act Rel. No. 50870 (Dec. 16, 2004), 69 Fed. Reg. 77424, 77461 (Dec. 27, 2004) (proposing Regulation NMS).

[57] Exchange Act Rule 603(c), 17 C.F.R. §240.603(c).

SIFMA appreciates this opportunity to comment on the issues raised in the Concept Release, as well as to offer its thoughts on other market issues and market structure principles. We look forward to further discussions about specific regulatory initiatives and equity market structure more generally with the Commission and its staff. If you have any comments or questions, please do not hesitate to contact me at 202.962.7300.

Sincerely,

Ann Vlcek
Managing Director and Associate General Counsel
SIFMA

cc: Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
Kathleen L. Casey, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
Robert W. Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets
Daniel Gray, Market Structure Counsel, Division of Trading and Markets

Exhibit C - Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (June 25, 2010) (SIFMA's comments on issues raised during the SEC's Market Structure Roundtable)

SIFMA

Securities Industry and
Financial Markets Association

June 25, 2010

By Electronic Mail (rule-comments@sec-gov)

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Market Structure Roundtable; File No. 4-602

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] welcomes the opportunity to comment on the range of issues raised during the Securities and Exchange Commission's ("SEC" or "Commission") Market Structure Roundtable. The following comments add to and complement the comments SIFMA has submitted on the SEC's recent market structure Concept Release[2] as well as the SEC's various market structure rule proposals, including those related to market access,[3] non-public trading interest,[4] consolidated audit trail,[5] and large trader reporting.[6] We appreciate the Commission's commitment to improving the national market system, and look forward to a continued dialogue with the Commission as it examines the equity markets and their regulation.

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1 The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit. www.sifma.org.

2 Securities Exchange Act Rel. No. 61358 (Jan. 14, 2010), 75 Fed. Reg. 3594 (Jan. 21, 2010); Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: Concept Release on Equity Market Structure (Apr. 29, 2010) ("SIFMA Concept Release Letter").

3 Securities Exchange Act Rel. No. 61379 (Jan. 19, 2010), 75 Fed. Reg. 4007 (Sept. 23, 2009); Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: Risk Management Controls for Brokers or Dealers with Market Access (Apr. 16, 2010) ("SIFMA Market Access Letter").

4 Securities Exchange Act Rel. No. 60997 (Nov. 13, 2009), 74 Fed. Reg. 61208 (Jan. 23, 2009); Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: Regulation of Non-Public Trading Interest (Feb. 18, 2010).

5 Securities Exchange Act Rel. No. 62174 (May 26, 2010), 75 Fed. Reg. 32556 (June 8, 2010) ("CAT Release"); SIFMA Concept Release Letter at 18-19.

6 Securities Exchange Act Rel. No. 61908 (Apr. 14, 2010), 75 Fed. Reg. 21456 (Apr. 23, 2010) ("Large Trader Release"); Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: The Large Trader Reporting System (June 24, 2010) ("SIFMA Large Trader Reporting Letter").

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A. Preventing Price Gaps and Erroneous Trades

The market disruption of May 6th highlighted the need to prevent price gaps and erroneous trades. The preliminary report ("Report") of the Commission and the Commodity Futures Trading Commission ("CFTC") regarding the events of May 6th points to a variety of often inter-related potential causes for the "temporary, breakdown in the market's price setting function when a number of stocks and ETFs were executed at clearly irrational prices."[7] We encourage the Commission to clarify the responsibility of trading venues to prevent price gaps and erroneous trades from occurring, thus reducing the need for declaring halts.

1. Stock-by-Stock Circuit Breaker Rules

The events of May 6th also highlighted inconsistencies regarding the circumstances in which trading may be paused in the various markets. The SEC responded quickly by approving stock-by-stock circuit breakers that pause trading in S&P 500 stocks across all U.S. equity markets for a five-minute period in the event that the stock experiences a 10 percent change in price over the preceding five minutes.[8] SIFMA supports these rules as a first step in addressing the structural issues highlighted on May 6th. However, we would encourage the SEC to ensure that all trading pause rules are the same across all markets going forward.

a. Expansion of Stock-by-Stock Circuit Breaker Rules

As noted, the stock-by-stock circuit breaker rules are limited in scope, as they only apply to the stocks in the S&P 500. We encourage the SEC to act expeditiously – and in advance of the conclusion of the 6-month pilot period – to expand the scope of the rules to other securities, particularly ETFs.[9] In this regard, we note that ETFs experienced significant volatility on May 6th and also would benefit from uniform pauses in trading.[10] We are also concerned that, as the pilot is expanded to more symbols, the current circuit breaker parameters will not be appropriate for low priced securities. We therefore suggest that securities priced below $5.00 be excluded from coverage under the pilot. Finally, we support further analyses of the linkages between the various financial markets; specifically, the SEC should continue to work with industry participants to explore how circuit breaker trading pauses should be treated across related markets, including the options and futures markets.

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7 SEC Approves New Stock-by-Stock Circuit Breaker Rules, SEC Press Release 2010-98 (June 10, 2010) ("Circuit Breaker Press Release").

8 See Securities Exchange Act Rel. No. 62251 (June 10, 2010), 75 Fed. Reg. 34183 (June 16, 2010) (approval of FINRA single stock circuit breaker); Securities Exchange Act Rel. No. 62252 (June 10, 2010), 75 Fed. Reg. 34186 (June 16, 2010) (approval of equity exchanges' single stock circuit breaker rules).

9 See Circuit Breaker Press Release (stating SEC's intention to expand the circuit breaker rules to other securities).

10 Preliminary Findings regarding the Market Events of May 6th 2010, Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues (May 18, 2010) ("May 6th Report") at 5-6.

b. Single Uniform Intermarket Trading Pause Rule

Various exchanges and FINRA have or are contemplating their own unique volatility rules that would permit those markets to halt trading in their markets under circumstances other than those set forth in the recently adopted stock-by-stock circuit breaker rules. For example, the NYSE's trading system incorporates liquidity refreshment points ("LRPs"), which, when one is triggered, pauses trading for a time to permit additional liquidity to enter the market.[11] Similarly, Nasdaq has proposed expanding its Volatility Guard rules which are similar to the NYSE LRPs.[12] SIFMA is concerned that, as noted in the SEC's preliminary report on the May 6th events, the imposition of disparate volatility rules may have the effect of exacerbating, rather than dampening, price volatility since orders may be routed to other, less liquid venues for immediate execution rather than waiting out the pause in trading.[13] In light of these concerns and the general need for regulatory consistency, SIFMA believes that a single, uniform intermarket rule should govern such stock-by-stock trading pauses and that any market-specific volatility rules should be eliminated.

2. Other Methods for Preventing Price Gaps and Erroneous Trades

SIFMA encourages the SEC to evaluate whether methods other than, or in addition to, trading halts would better serve the markets in limiting price gaps and erroneous trades. In particular, SIFMA believes that the following approaches are worth further consideration. These approaches would virtually eliminate the need to halt a security due to aberrant trading.

a. Limit Up/Down Approach

The SEC should consider the benefits of a "limit up/down" approach to controlling trading during volatile markets, similar to that utilized in the futures markets. In the futures markets, certain instruments may only trade within established price bands that are based on the prior day's close, known as limit up and limit down. Applying this concept to the securities context, once a designated stock price threshold is reached, trading could still continue but only within appropriate pre-set limits. Such an approach would largely eliminate erroneous trades and minimize the costs associated with interrupting continuous trading and denying market participants access to a continuous flow of market data during critical periods of time while still ensuring orderly market conditions. The key to the proper functioning of a limit up/down approach, of course, is the adoption of the correct trading band for various securities. We encourage consideration being given to establishing thresholds based upon market frequency (similar to the current single stock circuit breaker triggers) as opposed to using a static prior night's close. SIFMA encourages the Commission to compare the relative merits of this limit up/down approach with those associated with the use of circuit breakers.[14]

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11 See NYSE Rule 1000.

12 See SR-NASDAQ-2010-0066.

13 May 6th Report at 4.

14 We note that, if implemented effectively, the limit up/down approach would eliminate the possible need for market collars and the need to regulate stub quotes, as discussed below.

b. Collars on Market Orders

As the SEC described in its Report, some of the most inexplicable executions on May 6th resulted from the use of market orders during the period of extreme volatility.[15] As we saw, an unusually large influx of such orders can quickly use up all available liquidity across all markets, resulting in orders breaking through many price levels in an effort to obtain an execution at any price. SIFMA does not believe that the SEC should prohibit the use of market orders; such orders remain a valuable tool for investors seeking immediate liquidity, notwithstanding the risks associated with their use during volatile trading periods. However, the SEC should consider ways to minimize the risks related to the use of market orders, including their potential to contribute to sudden price moves. In this regard, SIFMA encourages the SEC to pursue initiatives to educate investors about the risks of market orders. In addition, the SEC should consider whether the imposition of collars on market orders would provide benefits to investors, or would detract from the trading flexibility that investors currently enjoy. We note that, like the limit up/down approach, the efficacy of market order collars would depend on the ability to establish the correct benchmark for the collar.

c. Stub Quotes

Stub quote executions were another source of erroneous trades on May 6th. As nominal quotes entered by market makers to meet their two-sided quote requirements, stub quotes are not intended to indicate actual trading interest. As a result, SIFMA recommends the elimination of stub quotes. Instead, we would encourage the SEC to consider other auto-quoting mechanisms, including establishing collars on quotes,[16] or material incentives for market makers to maintain their quotes.

B. Market-Wide Circuit Breakers

None of the existing market-wide circuit breakers, which apply across all equity trading venues and futures markets, were triggered by the events of May 6th. We support the SEC staff's efforts to evaluate how the market-wide circuit breakers should be recalibrated to be effective in today's fast paced electronic trading environment. In particular, the SEC should analyze how often the triggers have been hit, how often they should have been hit, and whether limitations on trading short of a trading pause may be beneficial under certain circumstances, and then introduce a reasonable proposal based on that data. Any modifications, however, should be coordinated between the securities and futures markets.

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[15] Id. at 75.

[16] In considering such measures, the SEC should evaluate the potential impact on message traffic in the marketplace to mitigate inefficiencies.

C. Market Center Obligations

1. Accurate and Accessible Market Data

SIFMA believes that it is critical for market centers to ensure that their market data is both accurate and accessible. Market centers should establish mechanisms for checking, verifying and reporting their market data. In doing so, they should have the means to handle their order flow so as to avoid redundant prices and extraneous prints. Moreover, rules applying any clearly erroneous policy should be very limited; permitting trades at an inappropriate price caused by preventable market data issues and addressing this problem by later breaking the trade should not be permitted. This is particularly troubling in light of the fact that, in many instances, trades do not occur in isolation. For example, broker-dealers may enter hedging or other offsetting transactions based on another trade in both the equities and derivatives markets. Thus, breaking one aspect of such related transactions as clearly erroneous but not the other may have significant consequences for firms. Finally, the market center's market data procedures should require the market center to pull its quote, or group of affected quotes when applicable (e.g., a given letter range), if the data becomes delayed, inaccessible or otherwise inaccurate.

2. Clearly Erroneous Policies

SIFMA supports the SEC's recent efforts to clarify the equity exchanges' and FINRA's processes for breaking erroneous trades.[17] We applaud the decision to curtail the markets' discretion in breaking erroneous trades and to impose uniform rules for breaking such trades. We urge the SEC, the exchanges and FINRA, however, to continue to work to ensure uniformity and consistency in the application of their clearly erroneous policies. In addition, we believe that the options exchanges should handle erroneous trades in a manner consistent with the equity markets. SIFMA looks forward to reviewing the SROs' recently proposed clearing erroneous trade rules.

3. Invocation of Self-Help

The SEC has identified the self-help remedy as another potential contributor to the May 6th market disruption.[18] Exchanges are entitled to exercise the self-help remedy under the Order Protection Rule when another exchange repeatedly fails to respond within one second. A declaration of self-help frees the declaring exchange from its obligation to route orders to the affected exchange. The self-help remedy was invoked against NYSE Arca during the disruption, thereby further limiting the available liquidity (although the provision of liquidity may have been

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[17] See Securities Exchange Act Rel. No. 62333 (June 21, 2010) (NYSE proposal); Securities Exchange Act Rel. No. 62331 (June 21, 2010) (NSX proposal); Securities Exchange Act Rel. No. 62336 (June 21, 2010) (CHX proposal); Securities Exchange Act Rel. No. 62337 (CBSX proposal); Securities Exchange Act Rel. No 62341 (June 21, 2010) (FINRA proposal); Securities Exchange Act Rel. No. 62334 (June 21, 2010) (NASDAQ Proposal); Securities Exchange Act Rel. No. 62330 (June 21, 2010) (ISE proposal); Securities Exchange Act Rel. 62340 (June 21, 2010) (BATS proposal); Securities Exchange Act Rel. No. 62338 (June 21, 2010) (EDGA proposal); Securities Exchange Act Rel. No. 62339 (June 21, 2010) (EDGX proposal); Securities Exchange Act Rel. No. 62342 (June 21, 2010) (NASDAQ OMX BX proposal); Securities Exchange Act Rel. No. 62332 (June 21, 2010) (NYSE Amex proposal). See also SEC to Publish for Public Comment Proposed Rules for Clearly Erroneous Trades, Press Release 2010-104 (June 17, 2010).

[18] May 6th Report at 5.

impaired in any event in light of apparent system issues at NYSE Arca). In light of the significant effect of declaring self-help – that is, the loss of liquidity of an entire market, SIFMA encourages the SEC to carefully analyze how it could tighten the self-help process by imposing uniform standards on when and how self-help may be utilized. For example, we would advocate more specific and uniform standards for when a market may invoke self-help on its own behalf as well as when one market may declare self-help against another market. Additional procedures should govern, at a minimum, how long the self-help period will last, how markets should be contacted, how market participants should be alerted to self-help being invoked, and how the self-help period will end. Indeed, the SEC may wish to consider the value of independent evaluations of the accessibility of the exchanges' quotes, both in real-time as well as in connection with self-help declarations.

4. Additional Market Center Disclosure

SIFMA believes that market participants would benefit from additional disclosures from market centers about their trading arrangements and practices. Such information would provide valuable information to market participants seeking to obtain best execution.[19]

5. ATS vs. Exchange Issues

More recently, there have been discussions about the extent to which alternative trading systems ("ATSs") may have more flexibility to engage in various practices than national securities exchanges. SIFMA believes the SEC should consider this issue, as well as others involving the relative costs and benefits of exchange vs. ATS designation, and whether the balance between these market centers is appropriate or needs to be adjusted. In doing so, the SEC should take into account differences between ATSs that operate as electronic communication networks, and those that operate as non-display trading venues. Moreover, any such assessment needs to be balanced and should not focus solely on benefits accruing to ATSs. We note, for example, that national securities exchanges receive significant benefits not available to ATSs, including benefits related to the use and sale of market data, lower clearing costs and no net capital requirements.

D. Market Maker Obligations

1. Definition of Market Maker

With the rise of high frequency trading, some have questioned whether the definition of a market maker should be expanded to include certain high frequency traders in light of some of the possible advantages such traders enjoy. As discussed in our comment letter on the SEC's Concept Release, SIFMA does not believe that there is a need to redefine a "market maker" at this time or to impose market maker obligations on high frequency traders.[20] It may, however, be useful for the Commission to consider how to better promote market liquidity by incentivizing market makers.

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[19] For a more detailed discussion, see SIFMA Concept Release Letter at 7.

[20] See SIFMA Concept Release Letter at 7.

2. Market Maker Obligations

As the events of May 6th highlighted, the current market maker obligations do not operate to ensure liquidity, particularly in volatile markets. SIFMA encourages the SEC to consider how best to enhance liquidity in those moments when it is most needed. The SEC should work with the exchanges to improve market maker auto-quoting mechanisms to better provide liquidity in times of duress (e.g., imposing collars on quotes). In addition, the SEC and the self-regulatory organizations should ensure that market makers are making appropriate use of their market making privileges (e.g., relying on their short sale exemption only if they are providing liquidity). The SEC also should consider more generally ways to ensure that liquidity does not flee the market, as discussed above, rather than looking to market makers to hold back the floodgates during volatile trading.

E. High Frequency Trading, High Speed Trading and Related Issues

SIFMA recognizes the value of high frequency trading in today's markets, particularly the significant liquidity provided to the market by such trading. However, as high frequency trading has increased, questions have arisen regarding the fairness of high frequency trading as well as the degree to which such trading exposes the equity markets to an unreasonable amount of systemic risk. As discussed in our comment letter on the equity markets Concept Release, SIFMA believes that the market would benefit from more disclosure about high frequency trading practices and how they affect the markets.[21]

1. Direct Market Data Feeds vs. Consolidated Data Feeds

SIFMA believes that it would be a significant step backward for the SEC to impose restrictions on the availability of market data or the content and transmission speed of such data. Rather than considering an approach that would slow technology or progress, the SEC should consider how to make direct market data feeds available to a broader universe of market participants, including retail investors, on fair and reasonable terms, and how to enhance the speed and content of consolidated market data. For example, the SEC might consider requiring market centers that sell their direct market data feeds to invest more heavily in ensuring that market data generated by the Consolidated Quotation System, Consolidated Tape Association and Nasdaq securities information processors is distributed efficiently, in a timely manner and with appropriately useful content.[22]

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21 For a more detailed discussion, see SIFMA Concept Release Letter at 5-11.

22 For a more detailed discussion, see SIFMA Concept Release Letter at 8.

2. Ensuring Appropriate Use of Direct Market Data Feeds

Direct market data feeds, which generally are faster and more detailed than the consolidated data feeds, provide market participants with valuable information. SIFMA notes, however, that such feeds may be used by third parties to attempt to derive more information about the markets than the providers of the data realize or intend to permit. For example, member firms state that direct market transaction information may be linked to particular displayed quotations and, in some instances, direct market data may be used to help discern the presence of reserve orders. SIFMA urges the SEC to consider whether it would be beneficial for market participants to have a better understanding of the ways in which their market data, if provided to a trading center publishing direct market data, might be used by other market participants. Better disclosure of these practices would facilitate the ability of market participants to opt-in or opt-out of the use of their data in this manner.[23] The SEC also should consider whether the level of implicit information provided by various market centers in direct market data feeds rises to a level akin to that of providing a quote or actionable indications of interest to the recipients of the data feed and, if so, what the implications of providing such data are under the SEC's Quote Rule.

3. Co-Location

SIFMA does not believe that firms participating in co-location arrangements, including the use of specialized data, lower latency data, or higher bandwith consumption, should have affirmative or negative obligations solely as a result of such arrangements. As noted in our Concept Release comment letter, we view co-location arrangements as sufficiently distinct from exchange specialist status that such obligations are not warranted.[24]

4. Minimum Duration for Quotes/Orders

In response to concerns about trading interest that is available for only very brief periods of time, some commenters have suggested imposing a minimum duration for quotes and orders. SIFMA opposes any such minimum duration requirements and, instead, encourages the SEC and the markets to explore other ways to incentivize longer display periods.[25]

F. Internalization and Undisplayed Liquidity

SIFMA believes that undisplayed liquidity, including internalization practices of broker-dealers, provides genuine benefits to the markets and their participants without detracting from the overall vibrancy of the displayed markets. As the SEC is aware, non-displayed liquidity often is used by market participants seeking to avoid adverse market impact when executing their trades. In addition, internalized executions by broker-dealers, in particular, provide investors – often retail investors – with speedy executions and, frequently, price improvement, mainly

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[23] For a more detailed discussion, see SIFMA Concept Release Letter at 8.

[24] For a more detailed discussion, see SIFMA Concept Release Letter at 7.

[25] For a more detailed discussion, see SIFMA Concept Release Letter at 9.

because broker-dealers retain control over the order execution process. Moreover, internalized orders that are not executed immediately are subject to display obligations where appropriate, thereby furthering the national quotation system. We note also that there is no current evidence to suggest that non-displayed liquidity would become displayed liquidity should the use of non-displaying trading venues be restricted.[26] In fact, it is possible that restricting the use of non-displayed trading venues would reduce the overall amount of available liquidity in the marketplace at any given time.

Indeed, the most recent studies we have seen – including a study concluded subsequent to the close of the Concept Release comment period – demonstrate that the availability of non-displayed liquidity venues have not, in fact, adversely impacted the displayed markets by impairing price discovery or execution quality. To the contrary, displayed markets remain healthy. For example, a very recent working paper on the impact of dark pools on market quality concludes that "a higher amount of dark pool activity is associated with lower quoted and effective spreads, lower price impacts, and lower short-term volatility. In other words, more dark pool activity is generally associated with higher market quality."[27]

G. Trade-At Rule

SIFMA strongly opposes the adoption of a trade-at rule. A trade-at rule would prohibit any trading center from executing a trade at the NBBO unless the trading center was displaying that price at the time it received the incoming contra-side order. Under such a rule, even reserve orders on exchanges would be required to protect away quotes before receiving an execution. As discussed in more detail in our comment letter on the Concept Release, [28] a trade-at rule would have detrimental effects on the speed and cost of execution, the liquidity currently available in the market, and the ability of investors to control their trading interests. Indeed, a trade-at rule comes very close to a consolidated limit order book or "CLOB" – a concept that has been repeatedly rejected by the SEC and market participants for many years as a threat to competition and innovation in our markets.[29] Given the absence of compelling evidence that non-displaying trading venues are impairing public price discovery – indeed, as discussed above, recent research suggests that more dark pool activity is generally associated with higher market quality, SIFMA does not believe that such a significant change in market structure is warranted. Moreover, while proponents of this idea view it as a way to stimulate greater display of limit orders, it is not at all clear that trading interest that an investor or broker-dealer has deemed is best represented on a non-displayed basis will, in fact, be sent for display in a trade-at environment. We note that there are already incentives for displaying liquidity, such as rebates, trade-through protection and minimum price variations.

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26 For a more detailed discussion, see SIFMA Concept Release Letter at 11-12.

27 Sabrina Buti, Barbara Rindi and Ingrid M. Werner, Diving into Dark Pools, Fisher College of Business Working Paper (available at http://fisher.osu.edu/fin/faculty/werner/working_papers.htm).

28 SIFMA Concept Release Letter at 12-14.

29 See, e.g., Securities Exchange Act Rel. No. 51808 (June 9, 2005); 70 Fed. Reg. 37496(June 29, 2005).

H. Access Fees and Sub-Penny Quoting

SIFMA continues to believe that quoting in sub-penny increments would not contribute to the maintenance of orderly markets. Sub-penny quoting would encourage market participants to "step ahead" of competing limit orders by submitting an order with an economically insignificant price enhancement to gain execution priority. Sub-penny quoting also poses both operational and technological challenges. Moreover, sub-penny quoting has implications in light of the existing "maker-taker" fee structures of various markets. For example, sub-penny quoting would be particularly problematic in the event market participants were to charge fees in excess of the spread for a stock. Thus, SIFMA believes that the SEC should study access fees and maker-taker rebate incentives and their potential effect on rebate arbitrage and execution quality.[30]

I. Market Data

As we have discussed on numerous occasions, SIFMA believes that the lack of competition with respect to the availability of market data continues to be a pressing concern for retail and institutional investors. We urge the SEC to study ways in which the content of market data may be enhanced and be made available to all investors on fair and reasonable terms.[31]

J. Risk Management – Market Access

As SIFMA discussed in greater detail in its comment letter on proposed Rule 15c3-5,[32] SIFMA, as a general matter, supports the use of pre- and post-trade controls on market access, and the general principle underlying the SEC's proposed Rule 15c3-5 that such controls and procedures are appropriate in market access arrangements. If, however, proposed Rule 15c3-5 is to be effective, certain significant, complex issues regarding market access and related credit risk must be addressed before the SEC adopts a final rule. For example, proposed Rule 15c3-5 does not appropriately distinguish market access arrangements involving multiple broker-dealers, each of which undertakes a different role in a transaction. Similarly, because many broker-dealers rely on third-party risk management technology, the SEC should clarify that a third-party vendor may control the underlying software of such risk management technology, so long as the broker-dealer is able to control the software's applied parameters and thresholds.

K. Regulatory Consistency

The current regulatory structure is beset by many conflicting or duplicative rules and regulations, regulatory initiatives and systems programming demands. This places unnecessary burdens on regulators and market participants alike, and poses significant risks to market efficiency and meaningful investor protection. As a result, we recommend that the SEC, SROs and other market participants undertake a comprehensive review of existing market structure and

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30 For a more detailed discussion, see SIFMA Concept Release Letter at 14-16.

31 For a more detailed discussion, see SIFMA Concept Release Letter at 22-23.

32 See SIFMA Market Access Letter. See also SIFMA Concept Release Letter at 10-11.

trading rules to identify conflicting or duplicative requirements that could be harmonized or eliminated. In addition, the regulators and firms must find ways to better coordinate and streamline system programming demands associated with regulatory changes. Moreover, in recognition of enhanced global connections of financial participants, SIFMA also believes that the SEC should pursue greater global regulatory coordination.[33]

L. Consolidated Audit Trail and Large Trader Reporting

SIFMA believes that an efficient, harmonized and market-wide regulatory consolidated audit trail would be a significant step in improving oversight of the markets and, therefore, supports the concept of a consolidated audit trail proposal.[34] For similar reasons, SIFMA supports the concept of large trader reporting.[35] However, we believe that the SEC's large trader reporting proposal should be part of the process of creating a consolidated audit trail, rather than a distinct process, in order to ensure that any large trader reporting regime implemented before the consolidated audit trail would be folded into the consolidated audit trail, once it is operational.[36] SIFMA recently filed a comment letter on the large trader reporting proposal, and looks forward to commenting on the consolidated audit trail proposal later this summer.

M. Rules 605 and 606: Market Quality and Order Routing Data

As discussed more fully in our Concept Release comment letter, we believe that Rules 605 and 606 could be improved upon in light of market developments in favor of more informative tools. For example, we believe that there is value in disclosing broker-dealers' potential conflicts of interest regarding order routing, as required by Rule 606; however, such disclosures could be provided by means other than Rule 606 reports, such as through broker-dealer websites.[37]

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33 For greater detail on regulatory consistency issues, see SIFMA Concept Release Letter at 20-21.

34 CAT Release.

35 Large Trader Release.

36 For a more detailed discussion of the consolidated audit trail and large trader reporting proposals, see SIFMA Large Trader Reporting Letter.

37 For a more detailed discussion of Rules 605 and 606, see SIFMA Concept Release Letter at 16-18.

SIFMA appreciates the opportunity to comment on the issues raised at the Market Structure Roundtable. We look forward to further discussions about specific regulatory initiatives and equity market structure more generally with the Commission and its staff. If you have any comments or questions, please do not hesitate to contact me at 202-962-7300 or alvcek@sifma.org.

Sincerely,

Ann L. Vlcek
Managing Director and
Associated General Counsel
SIFMA

cc: Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
Kathleen L. Casey, Commissioner
Troy A Paredes, Commissioner
Elisse B. Walter, Commissioner
Robert W. Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets
Daniel Gray, Market Structure Counsel, Division of Trading and Markets

Exhibit D - Letter from James T. McHale, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (Aug. 17, 2010) (SIFMA's comments on the SEC's proposal to established a consolidated audit trail")

SIFMA
Securities Industry and
Financial Markets Association

August 17, 2010

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

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

Re: Consolidated Audit Trail; Release No. 34-62174; File No. S7-11-10

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] welcomes the opportunity to comment on the recent proposal of the Securities and Exchange Commission (the "SEC") to establish a consolidated audit trail (the "Proposal").[2] We appreciate the SEC's efforts and agree that a consolidated audit trail is long overdue. Although SIFMA fully supports the concept of a consolidated audit trail, we believe the Proposal is overly ambitious and that there are other approaches that would be just as effective in reaching the SEC's goals with a significantly lesser burden and cost and that could be implemented much more quickly.

As detailed below, SIFMA supports the SEC's objective of providing regulators with timely access to a more robust and effective cross-market order and execution audit trail for NMS securities[3] and ultimately other securities. SIFMA believes that a centralized and

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[1] The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

[2] Consolidated Audit Trail, Exchange Act Release No. 62174, 75 Fed. Reg. 32,556 (May 26, 2010).

[3] "NMS security" is defined as "any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national (...continued)

comprehensive audit trail would enable the SEC and the securities self-regulatory organizations ("SROs") to perform their monitoring, enforcement and regulatory activities more effectively. In the current era of electronic trading, regulators need efficient access to order and execution data from both broker-dealers and exchanges. Indeed, a consolidated audit trail is a much-needed improvement over today's fragmented audit trail platforms.

In addition, over the long-term, the costs of developing a carefully designed and appropriately scaled consolidated audit trail could be offset in part by eliminating the individual SRO reporting requirements imposed under existing audit trail systems.[4] SIFMA encourages the SEC to phase-out these existing reporting systems as the consolidated audit trail is implemented across markets. SIFMA also urges the SEC and SROs to rely to the fullest extent possible on the consolidated audit trail data for market reconstructions, investigations and analyses rather than requesting data from broker-dealers. This would be more efficient for both firms and regulators and would help maximize the utility of the consolidated audit trail.

Although SIFMA supports this initiative in principle, SIFMA strongly believes that the consolidated audit trail proposed by the SEC is more expansive and expensive than necessary to achieve its intended purposes. The scope of the proposed consolidated audit trail is overly ambitious, particularly in requiring real-time reporting of a wide range of data elements. As a result, the proposed consolidated audit trail would take many years to implement and would impose enormous costs on broker-dealers and SROs to produce too much information far more quickly than is necessary for the regulatory purposes identified in the Proposal. It is difficult to justify such a complex, time-consuming, and costly project without a clear understanding of how the SEC and the SROs would use real-time data.

SIFMA, therefore, respectfully requests that the SEC more specifically define its regulatory objectives for a consolidated audit trail. Doing so would assist firms as they collaborate with SROs, data management experts and the industry to create a useful consolidated audit trail system.

(continued...)

market system plan for reporting transactions in listed options." 17 C.F.R. § 240.600(b)(46) (2010). The term refers to all exchange-listed securities, including equities and options.

[4] These systems include the Financial Industry Regulatory Authority, Inc.'s ("FINRA") order audit trail system ("OATS"), the New York Stock Exchange's Order Tracking System and Front End Systemic Capture, the Consolidated Options Audit Trail System, Large Option Position Reporting systems, electronic blue sheets and other SRO reporting and audit trail systems.

Moreover, as detailed below, SIFMA urges the SEC to modify the Proposal to: (i) lengthen reporting time frames where doing so would not thwart the key regulatory objectives of the SEC; (ii) eliminate nonessential data elements; (iii) build upon an existing audit trail, such as OATS, rather than create an entirely new system; (iv) coordinate the creation of a consolidated audit trail with the SEC's large trader reporting system proposal;[5] (v) provide further guidance on governance of the consolidated audit trail, particularly as it relates to safeguarding confidentiality of audit trail data; and (vi) address issues raised by the consolidated audit trail concerning foreign traders, funding, and the new Office of Financial Research.

I. Lengthen Reporting Time Frames

The Proposal would require each national securities exchange and national securities association, and their members, to provide the vast majority of audit trail data to the central repository on a real-time basis and provide post-execution information by midnight. SIFMA believes that the SEC should modify the proposed reporting time frames to be consistent with current protocols for trade execution and transaction processing. In particular, the SEC should lengthen these time frames for broker-dealers to a next-day, settlement date, or later deadline. Doing so would reduce the cost and time to market of the consolidated audit trail without compromising its effectiveness.

A. Eliminate the Real-Time Reporting Requirement

SIFMA believes that the SEC has underestimated the costs and risks associated with real-time reporting and has not clearly articulated why real-time reporting, rather than a reporting scheme that is more closely aligned with the current trading or settlement cycles or existing reporting regimes like OATS, is essential from a regulatory perspective. Real-time reporting would impose substantial costs on broker-dealers while producing few apparent benefits. In light of this, SIFMA believes that the SEC should replace the real-time reporting requirement for broker-dealers with a next-day or later reporting requirement. Exchanges and FINRA, on the other hand, could leverage their existing real-time monitoring tools and provide real-time trading information to the consolidated audit trail. Requiring real-time reporting only by exchanges and FINRA may sufficiently advance the SEC's goal of enabling cross-market monitoring and surveillance. Reports submitted by broker-dealers in the days following a transaction could be linked and integrated in the consolidated audit trail with the real-time reports from exchanges to allow full market reconstructions, while greatly minimizing overall implementation costs.

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[5] Large Trader Reporting System, Exchange Act Release No. 61908, 75 Fed. Reg. 21,456 (April 14, 2010).

An intermediate option would be for the SEC to require real-time reporting for only certain data elements. If the SEC were to adopt this approach, SIFMA strongly recommends that the SEC first consult with the industry to determine individual delivery schedules for specific data elements. Cost and privacy risks should be key factors in determining whether the burdens of real-time reporting outweigh its benefits. Competitive issues and availability of data should also be significant factors in deciding whether to require real-time reporting for a particular data element. Only data that is critical to the regulatory objectives of the consolidated audit trail and capable of being reported on a real-time basis should be subject to real-time reporting requirements, while all other data should be reported on a next-day or later reporting schedule. Moreover, information should be subject to real-time reporting only if all other data needed to use that information by putting it into context are also reported in real-time. Finally, any real-time reporting requirements should be phased in over time and on an extended implementation schedule. The costs, risks and limited benefits of real-time reporting are discussed in further detail below.

1. Costs and Risks of Real-Time Reporting

SIFMA has serious concerns about the costs and risks of real-time reporting. These costs and risks arise from a wide range of areas, including the difficulties of updating internal architecture at broker-dealers; the costs of operating and maintaining a vast real-time reporting system; problems with data quality; the exposure to market risk while gathering data to satisfy reporting requirements; the unavailability and disparate sources of information required to be submitted on a real-time basis; risks of peak capacity outages; inevitable flaws in clock synchronization; and challenges of data protection.

Broker-dealers would need to perform substantial work to implement real-time reporting. It is difficult to accurately estimate the incremental dollar cost of a real-time reporting system without first conducting extensive information gathering and sizing discussions. For example, updating internal systems for real-time reporting would require the participation of hundreds of project management, operations and information technology personnel. SIFMA members surmise that the cost per firm to implement real-time reporting could easily be in the many millions of dollars. The real-time capture of options quotes alone could cost more than the $2.1 billion that the SEC estimates to be the annualized cost of the entire system.[6] This is especially significant because firms' resources will be increasingly strained over the coming years as they implement numerous new regulatory initiatives, as well as the requirements of the Dodd-Frank Act. While it may be difficult to calculate these incremental costs, as a general matter it is intuitive that as the reporting requirement moves from post-event reporting to real-time, several types of

[6] Consolidated Audit Trail, 75 Fed. Reg. at 32,601.

costs would be expected to rise exponentially. These costs include not only the expenses to establish and maintain a real-time infrastructure, but also the greater risk of regulatory exposure for firms that cannot achieve a 100 percent compliance rate due to mere technical violations. There also would be data integrity costs in the form of less reliable data, or data that would have to be revised or resubmitted where it otherwise may not have been required if firms had a short window of time to more thoroughly "scrub" or validate their submissions.

To implement real-time reporting, the internal architecture of broker-dealers would need to be significantly redesigned, especially because, at present, broker-dealers are generally not subject to real-time reporting requirements. Many existing broker-dealer processes for order handling and reporting involve linking data from the front office to the back office. A typical process involves using downstream systems that feed audit trails, linking trading events from various separate systems and then assigning a unique order identification number after the fact through batch processing. At the time that the downstream system links the data together, various data normalization and enrichment processes take place that are essential to ensuring high quality data are produced. To allow for real-time reporting, all of these steps would need to be pushed upstream, which would be a monumental task in itself, and one that could also interrupt trading flows and negatively impact data quality.

In addition to implementation costs, real-time systems would result in higher operations and maintenance costs. Remediation of reporting anomalies in a real-time environment would be particularly challenging, from both a technical and operational standpoint. Data quality therefore could be more likely to suffer in a real-time reporting system to the extent that firms are unable to repair reports for many common issues such as symbol changes, corporate actions and system outages or "downtime." In existing audit trail regimes, firms have longer reporting time frames and therefore can make needed changes and control the quality of reported data. Even so, many technical violations occur and result in fines despite the best efforts and internal verifications of FINRA members. Real-time reporting would also require firms to design enhanced data storage protection systems. Elaborate data protection schemes would be necessary to mitigate security risks arising from having information about both open and executed orders available centrally on an intra-day basis.

SIFMA is also concerned that real-time reporting would increase market risk. The consolidated audit trail would create new dependencies on non-trading systems, such as customer information databases and other reference data. Any weaknesses in such systems could delay the routing of client orders to trading centers for execution. Order handling and reporting would also be delayed in cases where internal identifiers must be replaced with standard identifiers required by the Proposal. For example, sales systems often maintain branch and registered representative information based on an internal identification number, but the consolidated audit trail would require that orders be enriched with standard registered representative identifiers. Although SIFMA welcomes

the standardization of registered representative identifiers, the process of translating internal identifiers into standard identifiers in real-time would be difficult and require the introduction of new processes at firms.

Real-time reporting would also increase the risk of peak capacity outages. For a single order, there may be hundreds of messages that must be transmitted to the central repository. The bandwidth that such messages would require, in combination with the bandwidth needed for processing the orders and trades themselves, could pose significant risks of system outages, particularly at peak trading times, at order handling firms, trading centers and the central repository. These risks would be most pronounced for systems handling options because options generate many more messages than equities, as evidenced by the number of messages generated through the Options Price Reporting Authority as compared to the number of messages generated through the Consolidated Tape System.

The most significant challenge associated with the proposed real-time reporting system is that certain data elements required to be reported on a real-time basis are simply unavailable on a real-time basis. These elements may not be available until the close of the market or, in some cases, the next trading day. As a result, a real-time reporting requirement would mean that partial records would be passed through the consolidated audit trail in real-time, thereby necessitating new systems and operations for complicated record and data matching and reconciliation processing in the consolidated audit trail. Customer information is one type of data that could not feasibly be provided on a real-time basis. Providing such information would require time-intensive data look-ups given that most institutional orders are sent to firms in blocks and often from multiple accounts. In addition, a requirement to provide detailed customer information on a real-time basis would in many cases be at odds with current market practice. In large clearing firms, this information may not be available until the end of the trading day or late in the evening at best. Once allocation information is available, the process of tagging the uploaded allocation to the original trade would require more time. Reporting broker-dealers would have to rely on the uploaded allocation information for a trade initiated by a different broker-dealer to have sufficient information to tie the trade back to the beneficial owner.

2. *Limited Benefits of Real-Time Reporting*

SIFMA believes that the benefits of real-time reporting are far from apparent in the Proposal, and, in fact, any benefits would be limited. While the SEC describes in the Proposal how real-time reporting hypothetically could be valuable for certain surveillance purposes, the SEC does not describe how in practice it would utilize the vast amounts of consolidated audit trail data it would receive in real-time. Presumably, entirely new electronic systems, procedures and reports would need to be developed and implemented at the SEC to process this information. Without the demonstrated ability to utilize the information on a real-time basis for surveillance purposes, any incremental benefits of

real-time reporting, rather than next-day or later reporting, do not warrant the costs of implementing a real-time reporting system.

Also, trading centers already have access to real-time data for market surveillance that is likely to allow intraday intervention regarding apparent trading patterns. Therefore, any new information that broker-dealers would have to report under the Proposal should be information that is used by the SEC for cross-market oversight, investigations and event reconstruction, rather than to duplicate existing monitoring by SROs, exchanges and markets. This existing monitoring is designed to detect and prevent errors and potential market manipulation and is best performed at the marketplace level.

Furthermore, real-time information cannot prove intent, which is a necessary element for fraud and manipulation actions. The SEC states in the Proposal that "knowing when in time the customer opened the account in relation to the suspicious trading activity, or whether the customer changed account authorization to permit options trading just before suspicious options trading, could be evidence of intent."[7] Although SIFMA appreciates the regulatory value of such information, much of the information required to be reported to the consolidated audit trail would be largely irrelevant for real-time surveillance and can still be obtained on a next-day basis (or later) through channels already available to the SEC. Even where certain information would be useful on a real-time basis, broker-dealers should not have to comply with a real-time reporting requirement if the SEC does not have mechanisms in place for using the data in real-time.

SIFMA also recognizes the SEC's desire to conduct prompt market reconstructions, highlighted by the recent May 6, 2010 "flash crash." SIFMA members worked closely with the SEC to provide key data to explore that event. However, the proposed consolidated audit trail will not fulfill the SEC's desire for immediate market reconstruction, because it lacks futures and swaps information. The SEC is dependent on the CFTC for this information, and will not receive it in real-time. Without this data, it is impossible to reconstruct any modern market event, and, therefore, the SEC will continue to be unable to reconstruct market trading on a real-time basis, even with a real-time reporting system for securities. SIFMA also would like to point out that, even in the absence of a consolidated audit trail today, regulators have nonetheless been able to conduct market reconstructions in much shorter time frames than they have in the past. For example, the SEC staff issued its study, "The October 1987 Market Break,"[8] in February 1988, approximately four months after the market events of October 19, 1987. More recently, a joint SEC-CFTC staff report detailing the preliminary findings of the

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[7] Consolidated Audit Trail, 75 Fed. Reg. at 32,573.

[8] SEC, Division of Market Regulation, *The October 1987 Market Break* (Feb. 1988).

May 6, 2010 "flash crash" was published just 12 days after the event.[9] SIFMA recognizes that more analyses of that event may be reported in the future, but simply notes that regulators have the means to obtain and compile important information promptly, even in the current trading environment.

B. Extend the Post-Execution Reporting Deadline

SIFMA also believes that the data required to be reported by midnight under the Proposal should be reported on a more extended timeline.[10] Requiring broker-dealers to comply with a midnight reporting standard for certain data elements could disrupt the operational life cycle of trading various products. Much of the information required to be reported by midnight is currently unavailable to broker-dealers within that time period or may be modified on the next day. For instance, short-sale borrow information and certain sub-account allocations are typically not available by midnight of the trade date. The SEC states in the Proposal that the midnight deadline was selected for certain information because real-time reporting "may not be practical or feasible for all information because the information may not be known at the time of the reportable event."[11] SIFMA believes that the SEC has underestimated the amount of time that execution allocation can take. More time is needed for broker-dealers to allocate late executions from international accounts, to establish post-trade linkages to executions for non-straight through processed trades and incorporate as-of-trade adjustments based on trade and clearing breaks. Implementing a next-day, settlement date, or later reporting requirement would increase the likelihood that this information will be obtained, while still providing regulators with timely access to such information.

II. Better Focus in the Scope of the Consolidated Audit Trail

A workable and tailored consolidated audit trail would enhance the SEC's ability to maintain fair and orderly markets. However, as proposed, the consolidated audit trail is an overly ambitious and costly means to obtain the data that are realistically needed to enhance the SEC's and the SROs' market surveillance activities. SIFMA recommends

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[9] Preliminary Findings Regarding the Market Events of May 6, 2010, Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues (May 18, 2010).

[10] Consolidated Audit Trail, 75 Fed. Reg. at 32,573. The information that must be reported on this timeline includes: the account number for any subaccounts to which the execution is allocated (in whole or in part); the unique identifier of the clearing broker or prime broker, if applicable; the unique order identifier of any contra-side order(s); special settlement terms, if applicable; short sale borrow information and identifier; the amount of a commission, if any, paid by the customer, and the unique identifier of the broker-dealer(s) to whom the commission is paid; and, if the execution is cancelled, a cancelled trade indicator.

[11] *Id.*

that the SEC better focus the scope of the proposed consolidated audit trail to enable the capture of the most pertinent information to ensure its workability and reduce its cost and time to market. The Proposal would require a vastly expanded number of new data elements to be reported to the consolidated audit trail. Some of this information is not currently collected or stored by broker-dealers because it is not required by other audit trails. Therefore, mandating the reporting of these data elements would impose considerable operational, technological and economic burdens on broker-dealers. SIFMA recognizes that many of these data elements are critical to the success of the consolidated audit trail. A unique identifier for broker-dealers and national securities exchanges, for example, would simplify market surveillance. At the same time, SIFMA believes that the number of data elements in the consolidated audit trail should be reduced to achieve the appropriate balance between furthering the regulatory objectives of the consolidated audit trail and mitigating costs for broker-dealers and the market overall.

A. Customer Account Information

SIFMA believes that the amount of customer account information that is required to be included on every order is excessive for the purpose of identifying customers.[12] The proposed amount of customer account information far exceeds the amount in existing audit trails. Collecting, storing and reporting all of this customer information for the audit trail would require the development of new internal systems or linkages between existing internal databases and thus could slow down the order handling or reporting process. To the extent a unique customer identifier is required to be submitted to the consolidated audit trail, reporting all of the additional proposed customer information would be redundant. Furthermore, the large trader identification number should be sufficient to ensure that the SEC is able to identify large traders, who use omnibus accounts, trade through multiple accounts and are the main targets of regulatory surveillance. The SEC should therefore revise the proposed rule to remove some of the customer account data elements.

B. Unique Customer Identifier

The Proposal calls for the creation of a unique customer identifier that would attach to each order at the time the order is received or originated by a member and remain with the order through the process of routing, modification, cancellation and execution. SIFMA believes the consolidated audit trail should not include a unique customer identifier for every customer. First, creating and assigning unique customer identifiers for all customers would be expensive, raise serious concerns about privacy and be prone to errors. Given these drawbacks, the SEC should not require unique customer identifiers and should

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[12] The Proposal would require that the following customer account information be reported for every receipt or origination of an order: account number, account type, customer type, date the account was opened and the large trader identification number (if applicable).

instead rely on the large trader identifiers. By doing so, the SEC would focus its efforts on the transactions that present the greatest risk of moving markets, ease the financial burden on firms, reduce investor privacy concerns and clear the path to inaugurating the consolidated audit trail.

While the SEC does not specify who would create or input the unique customer identifiers, it suggests that the central repository could assign the identifiers on the basis of a customer's social security number or taxpayer identification number. This raises serious privacy concerns. In recent years, increased concerns about identity theft and client confidentiality have led the securities industry to move away from using social security identification numbers or taxpayer identification numbers as a way to monitor clients and customers. The SEC has affirmed that it would guard access to customer social security and taxpayer identification numbers with even more safeguards than it does other information in the central repository of the consolidated audit trail. Although the SEC has a strong record of protecting investor privacy, the very presence of potentially billions of unique customer identifiers tied to personal information in a central repository would create a substantial risk of misuse and identity theft. The risk of unique customer identifiers being stolen or misused would be magnified in a real-time reporting system.

The work required to update internal architecture to report customer identifiers to the consolidated audit trail would be substantial. The implementation of a centralized process for assigning, storing and utilizing standardized unique customer identifiers would be made difficult by the fact that handling systems and processes may access and maintain customer (and proprietary) identification information in different ways and at different levels of specificity. New operational processes would need to be established to request or validate unique customer identification numbers, and system changes would need to be made to store these identification numbers in internal reference data systems. Furthermore, all sales and trading systems would need to be modified to maintain the unique order identification numbers because of the requirement that the identifiers must be included on all orders reported to the consolidated audit trail. The requirement for real-time reporting would make this process all the more challenging because it would require order handling systems to be revised to use and store unique customer identifiers. Firms and SROs would also incur significant costs in maintaining and safeguarding the unique customer identifiers.

The sheer scale of the process of inputting customer identifiers is likely to result in a significant number of errors. The number of errors would be multiplied in a real-time system because numerous broker-dealers, traders and other market participants would have to input a unique customer identifier in an order at every step until its ultimate execution. A unique customer identification system that contains a significant number of mismatches and input errors would preclude quick and accurate identification of market participants and therefore would be of limited value to regulators.

The SEC could alleviate many of these burdens, and increase the effectiveness of an identification system, if it required only large trader identification numbers to be reported instead of requiring a unique customer identifier for every customer. As a practical matter, the SEC and SROs are unlikely to be interested in routine transactions by small investors. On the other hand, the regulators are much more likely to need accurate information about the orders of large traders because they are most likely to engage in transactions large enough to impact prices. Thus, requiring large trader identification numbers in the consolidated audit trail instead of unique customer identifiers for all customers would better tailor the consolidated audit trail to the regulatory needs of the SEC and SROs.

For similar reasons, the SEC should not affix unique customer identifiers to computer algorithms. The SEC states in the Proposal that it is considering whether unique customer identifiers should be used to identify algorithms so regulators could better detect a pattern of suspicious trading activity from a specific trading desk or algorithm. However, firms would face significant logistical and operational burdens in creating unique customer identifiers for algorithms. Algorithms often change daily, raising questions of whether a new number is needed. Firms would also need to develop safeguards to ensure proprietary algorithms and trading strategies are not co-opted by competitors. To the extent the SEC desires information about algorithms, a simple flag to denote orders generated by algorithms could be included in the consolidated audit trail. This modification, which would be much less expensive to implement than generating unique customer identifiers for all algorithms, would also satisfy the SEC's regulatory objective of quickly distinguishing orders generated by different algorithms.

Alternatively, if the SEC determines that unique customer identifiers are necessary, SIFMA recommends certain modifications. First, the SEC should provide clearly defined rules for the unique customer identifier to ensure a level playing field. In particular, the SEC should specify whether the unique customer identifier is required to be submitted at the time of the order and provide a procedure for what should be done if an identifier is not available. The SEC should also provide a definition for the terms "beneficial owner" and "customer" to eliminate any doubts as to whom these labels apply. For example, is the "customer" the entity directing the trade or the beneficial owner of the account? Third, the SEC should mandate that the unique customer identifiers may never be used by firms for any other purpose, such as account access or authentication. If firms were to use the unique customer identifiers for purposes other than the consolidated audit trail, it would heighten the threat of identity theft and fraud. Finally, for registered investment advisers, the unique customer identifier should be associated with the investment adviser rather than the underlying beneficial owner. Frequently, investment advisers aggregate orders for multiple beneficial owners in "bulk" orders that are routed together and allocated on an average-priced basis to ensure best execution.

C. Unique Broker-Dealer and Exchange Identifiers and Standard Symbols

The Proposal would require that every exchange and member have a unique identifier that is reported each time an order is initiated, routed, received or executed. SIFMA believes that this standardization of naming conventions is important because currently members have different identifiers on different exchanges and trading venues. Each broker should have one, single identifier that is used by every exchange and trading venue. One consistent identifier should be used by a broker-dealer regardless of where its order is routed or executed. In addition, SIFMA urges the SEC to mandate the use of standard security symbols across all markets.[13]

D. Unique Order Identifiers

The Proposal envisions that members would "tag" each order received or originated by the member with a unique order identifier that would be reported to the central repository and stay with that order throughout its life, including routing, modification, execution and cancellation. SIFMA believes that the unique order identification number poses a number of challenges. First, creating and reporting a unique order identification number through the entire order life cycle and across "handoffs" between market participants would very likely require members to include the originating firm's or customer's name as part of the identifier. Passing it from system to system through the whole order life cycle would create potential privacy information risks as every new destination (both internally across information barriers within a firm and externally across broker-dealers) would see where an order originated. SIFMA believes that the OATS requirement of only maintaining unique order identifiers on transactions reported within each broker-dealer is more appropriate. The OATS requirement to report a routed order identifier across each link in the transaction chain when an order is sent from member to member would suffice for linking orders within the consolidated audit trail reporting system and would not compromise private customer information across broker-dealers. SIFMA believes that when orders are merged, a new merged order identifier should be assigned and used for subsequent order handling events to avoid having to pass multiple unique order identification numbers on to every subsequent "child" order related to the original "parent" orders. Finally, the SEC should standardize, with specificity, how the order identifier should be structured to ensure consistent reporting among firms. For example, the SEC should clearly state whether firms should provide explicit guidance on the use of spaces, dashes and leading zeros in unique order identifiers.

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[13] *See also* Section VI, C, "Office of Financial Research," *infra*.

E. Quotations

SIFMA strongly opposes the proposed requirement for broker-dealers to report quotations for new and routed orders in NMS securities to the consolidated audit trail. The volume of quotation information in today's markets dwarfs the volume of order and trade information. The submission of quote data therefore would result in a need for increased capacity and performance of internal systems that feed information to the consolidated audit trail. The central repository likewise would need to be capable of handling greater volume and complexity of data.

In the first instance, SIFMA believes that rather than requiring quote reporting by broker-dealers, only the exchanges and FINRA (through its Alternative Display Facility and proposed Quotation Consolidation Facility[14]) should be required to report quotations. The exchanges and FINRA, which currently receive quotation information, could report this information at a lower cost and with more accuracy. The exchanges and FINRA are in a position to provide quotation information with greater precision because all quotation information would be based off of a single time clock for each exchange and for FINRA rather than the time clocks of each submitting firm, which, even with clock synchronization efforts, would likely vary. This approach to quotation reporting would also benefit the system overall because the consolidated audit trail would only have to process high-volume quotation data once per quote instead of through two independent reports by broker-dealers and exchanges.

In the alternative, if the SEC instead determines that broker-dealer reporting of quotations is necessary, then certain adjustments to the Proposal should be made to mitigate the burden of this requirement. First, quotation reporting should be implemented as a separate step from the overall implementation of the consolidated audit trail. Initial implementation of the consolidated audit trail should focus on non-quote transactions. This is the area that will provide the greatest value to the SEC and the SROs in their market monitoring and surveillance efforts. Second, the amount of quotation information that must be reported to the consolidated audit trail should be reduced. The SEC should only require reporting of quotations that change an exchange's best bid or offer. Finally, options market maker quotes should be exempted. Options market makers in the aggregate quote billions of times each day, and like equity quotes, these quotations can be obtained from the exchanges.

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[14] Quotation Consolidation Facility, Exchange Act Release No. 34-60999, 74 Fed. Reg. 61,183 (proposed Nov. 13, 2009).

F. Clock Synchronization and Millisecond Reporting

The SEC proposes that clocks be synchronized to the "time maintained by the National Institute of Standards and Technology (the "NIST"), consistent with industry standards," but does not specify a standard within which clocks must be synchronized to the NIST. A standard that is shorter than the current three second standard may be impossible to achieve across the disparate entities that would be subject to the consolidated audit trail. Variations in clocks due to clock drift and correction could yield false results. The SEC should also reevaluate the need for millisecond reporting. Although firm systems tend to capture timestamps in milliseconds, reporting in milliseconds would require changes to internal systems given that existing audit trails such as OATS require reporting of timestamps accurate only to the second.

G. Post-Execution Transaction Attributes

There are a number of post-execution transaction attributes that should not be added to the consolidated audit trail unless the surveillance benefits of doing so are proven to outweigh the costs. Broker-dealers collect most of the post-execution transaction attributes that would be required to be reported, but the information is located in systems that are separate and distinct from order handling and trading systems. Updating internal architecture to enrich orders with each one of these data elements would entail a technically and operationally complex process. The challenges of doing so would be multiplied, perhaps insurmountably so, if real-time reporting were required. For example, short sale borrow information, commissions and sub-account allocations are located in systems distinct from trading systems. Commissions would also be difficult to determine on a trade-by-trade basis. Sub-account allocations, which would be required on every executed order, are similarly complicated by the fact that orders and allocations are handled in completely separate systems. Although some firms have straight-through processing with linkages between the front-office execution and middle-office allocation systems, the extraction and linkage of this information for reporting purposes would require substantial changes. Any manual changes in the allocation process would break front to back office linkages and would be difficult to reestablish for subsequent consolidated audit trail reporting. In addition, establishing post-trade linkages between executions and allocations may be impossible in some cases, such as average price transactions.

SIFMA is also concerned about other data elements that broker-dealers do not currently collect. For example, broker-dealers do not typically collect information on the identity of the customer representative who gives a modification or cancellation instruction. Likewise, no existing equity trading systems currently maintain information on open and close indicators and prior positions on the order level. It would be very challenging for member firms to maintain current position information for the firm and clients during the day

across different desks and aggregation units. Furthermore, where clients trade though different brokers or accounts, this information is not feasible to determine and maintain.

H. Data Element Phase-In

To the extent the SEC ultimately requires new data elements to be reported as "material terms" of an order that are different from those required by other audit trails such as OATS, SIFMA urges the SEC to phase-in the introduction of these new data elements. This would allow broker-dealers to manage more effectively the costs and resources required to build out existing systems to accommodate reporting of this new information.

I. Proprietary Orders

SIFMA agrees with the SEC that proprietary orders should be included in the consolidated audit trail in order to achieve the SEC's stated goals of improving cross-market monitoring and surveillance. SIFMA believes, however, that the SEC should take a more tailored approach to proprietary orders and narrow the requirements that would apply. First, non-trading transfers of securities within a legal entity, such as internal journals of securities within a desk or aggregation unit, should be exempt from the reporting requirements; at the same time, however, firms should be permitted to include such internal transfers in the consolidated audit trail with a special indicator. OATS provides a useful model for this as it enables the reporting of an execution resulting from an intra-entity trade with an appropriate indicator to denote that it should not attempt to be matched to an associated Trade Reporting Facility trade report. Second, certain consolidated audit trail order attributes, such as special handling codes, may be less relevant for proprietary orders and could be excluded. The proposed inclusion of a prior position in a security for proprietary orders and stock open and close indicators would be complicated by the usage of aggregation units within many firms because proprietary order handling systems reference aggregation unit positions for order marking rather than individual account positions.

III. Expand an Existing Audit Trail Rather than Start from Scratch

SIFMA believes that building out an existing audit trail to accomplish the goals of a consolidated audit trail would be preferable to creating an entirely new system. Using an existing system to create the consolidated audit trail would save time, reduce costs and leverage existing privacy controls.

In the Proposal, the SEC preliminarily dismisses the option of using existing audit trails to achieve the objectives of the consolidated audit trail because of "the lack of uniformity as to the type of audit trail information gathered by the different exchanges and FINRA, and

the lack of compatibility in the format of each SRO's audit trail data."[15] The SEC also states its concern that "certain information about orders and executions that would be useful to efficient and effective regulation of inter-market trading activity and prevention of manipulative practices is not captured by existing audit trails."[16] It appears, therefore, that the SEC has considered pooling the data collected by existing audit trails but has not considered, or at least not offered reasons why it does not support, the option of building out a single existing audit trail to provide additional information, in a uniform format across markets, to a central repository. SIFMA urges the SEC to explore this latter option and, in particular, consider using OATS as the foundation for the consolidated audit trail.

A. OATS as the Foundation for the Consolidated Audit Trail

SIFMA believes that using a system like OATS would be an efficient and effective route towards achieving a consolidated audit trail. First, there is significant overlap between the information required to be reported to OATS and the information that the SEC would require to be included in the consolidated audit trail. Firms that report to OATS, for example, are required to submit with their orders, a unique order identifier, customer account type, the date and time the order was originated, transmitted or received (in seconds), the size and type of an order and any special handling instructions. Because of the existing infrastructure that OATS offers, we understand that FINRA has estimated that the cost of expanding OATS would be in the tens of millions of dollars, rather than in the billions of dollars, assuming the system is not real-time and that options reporting is not included at the outset.

Using OATS, or a system like it, would also mitigate confidentiality concerns because instead of requiring unique order identifiers, the system could use routed order identifiers across each handoff. While the task of joining multiple submissions to form a complete picture would require more processing on the back end than the proposed consolidated audit trail, it would help ensure that information is secure and that privacy in the marketplace is protected.

B. A Phased Approach to Building Out OATS

If OATS were used as the foundation for the consolidated audit trail, SIFMA recommends that the SEC mandate a phased approach for implementation. To meet the SEC's objectives, OATS would need to be expanded to include the following categories: non-

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[15] Consolidated Audit Trail, 75 Fed. Reg. at 32,565.

[16] *Id.*

Nasdaq-listed securities,[17] listed options, quotes, street side and exchange-to-exchange routes and market making. A targeted, core audit trail system should be developed initially for NMS stocks and enhanced over time to create a complete audit trail, phasing in any new required attributes and subsequently adding listed options and then non-NMS securities.

Focusing on listed options before all other non-NMS securities are included would be preferable because options are generally characterized by more electronic and standardized handling systems and straight-through trade processing. OTC derivatives and fixed income securities, on the other hand, are characterized by more manual and negotiated trading flows and systems and are significantly less automated from a straight-through processing perspective. Therefore, implementing the consolidated audit trail for this latter set of products would require more work to standardize front office order audit trail information and establish post-trade linkages and enrichments. As OATS is expanded to include new products, existing audit trail systems for such products (*e.g.,* COATS) should be retired. Furthermore, once market makers begin reporting to the consolidated audit trail, non-tape, regulatory reports to the Trade Reporting Facility should be eliminated (while tape reporting should remain intact).

SIFMA believes that a number of governance and infrastructure changes would also need to be made to OATS. A NMS plan would be necessary to address creation, administration and governance of the consolidated audit trail and the central repository. The central repository should be designed to support and allow the reporting of consolidated audit trail data by third-party order handlers on behalf of broker-dealers, as is the case with OATS today. It would also be necessary to specify who would be responsible for governing the consolidated audit trail and how it would be operated, who would have access to central repository data and how costs would be allocated, among other things. Furthermore, reform of the existing fee system for OATS violations would be necessary to ensure a more workable approach in an expanded audit trail context. A new plan for dealing with minor rule violations could be devised that would provide support for corrections of deficiencies within reasonable time frames in lieu of punitive fines.

SIFMA notes that OATS is far from a perfect system and that it would take considerable improvements to make OATS more workable and flexible if the SEC selected it as the foundation for a consolidated audit trail. The use of a legacy system would require redesigning the system to expand its capacity and efficiency, which in turn would require the cooperation and dedication of FINRA. One way of improving OATS would be to

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[17] SIFMA notes that FINRA recently proposed to expand OATS to include all NMS stocks. *See* SR-FINRA-2010-044 (filed with the SEC on Aug. 6, 2010). Rule 600(b)(47) of Regulation NMS defines "NMS stock" as "any NMS security other than an option." 17 CFR 242.600(b)(47). FINRA notes in the rule filing its understanding that the NYSE will propose to retire OTS upon the expansion of OATS to all NMS stocks.

introduce FIX Protocol to replace the current data entry system in OATS. Second, OATS should be simplified by eliminating obscure labels and definitions and cutting out redundant reports for orders, including intra-firm routes or "desk" reports. Third, the window for firms to repair OATS rejections should be extended beyond the current five-day period. In addition, mismatch reports should be provided more quickly to firms; currently it takes several days after data is submitted for a firm to receive a mismatch report. SIFMA notes that these examples are provided only for illustration and are not intended to be an exhaustive list; extensive consideration would need to be given to this area should OATS be used.

IV. Coordinate the Consolidated Audit Trail with the Large Trader Reporting System

SIFMA urges the SEC to coordinate the design and implementation of the consolidated audit trail with the proposed large trader system, both of which are intended to enhance the SEC's and the SROs' capabilities to reconstruct market trading activity in NMS securities. As described in our comment letter that was submitted to the SEC on June 24, 2010 (the "SIFMA LTRS Letter"),[18] SIFMA supports the objectives of the large trader reporting system but urges the SEC to modify it to operate in tandem with the Proposal. The SEC states that "[t]he large trader proposal is designed to address in the near term the Commission's current need for access to more information about large traders and their activities."[19] SIFMA believes that properly designing the large trader reporting system to be an interim step would address the near term needs of the SEC while laying the foundation and making progress towards the consolidated audit trail. There is a high degree of overlap between the large trader reporting system and the consolidated audit trail. Some of this overlap is complementary, but there also appears to be considerable redundancy. SIFMA respectfully requests that the SEC work to identify and then mandate at this time only those elements of the large trader system that would continue to operate as part of the consolidated audit trail. By only implementing those parts of the large trader reporting system that can be leveraged towards building the consolidated audit trail, the SEC would facilitate the creation of a consolidated audit trail in a more efficient and timely manner by minimizing costs and avoiding redundant systems and duplication of efforts.

In particular, SIFMA believes that the SEC should implement only the large trader identification portion of the proposal. Specifically, a large trader could be required to

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[18] SIFMA, Comment Letter on the Proposed Large Trader Reporting System (filed June 24, 2010), *available at* http://www.sec.gov/comments/s7-10-10/s71010-86.pdf.

[19] Consolidated Audit Trail, 75 Fed. Reg. at 32,557.

register with the SEC and disclose its large trader identification number to the broker-dealers effecting transactions on its behalf and to all others with whom it collectively exercises investment discretion. Because the consolidated audit trail would include large trader identification numbers, the SEC, rather than broker-dealers, would be able to monitor for unidentified large traders by joining order and trade information with customer data sets obtained through the large trader identification numbers and certain account beneficial ownership and trade authority information that are reported to the consolidated audit trail. This would obviate the need for each broker-dealer to design, implement and maintain its own costly monitoring systems for large traders.

The SIFMA LTRS Letter also recommends that the SEC consider an incremental expansion of OATS for the large trader reporting system. Using the OATS framework for the consolidated audit trail and the large trader reporting system would be an efficient and cost-effective means to achieve the SEC's goal of a consolidated audit trail.

V. Protect the Confidentiality of Consolidated Audit Trail Data

The SEC should take additional steps to safeguard the privacy of data in the consolidated audit trail. Under the Proposal, the SEC, the national securities exchanges and FINRA would be able to examine all of the information in the central repository at any time for any regulatory purpose. Granting that type of sweeping access to a massive database filled with confidential information would increase the risk that consolidated audit trail data would inadvertently be made public or misused. The SEC should restrict access to the consolidated audit trail repository even further and specify the security measures and information barriers it would have in place to prevent the leakage or improper use of confidential data.

The central repository arguably could be one of the largest, most commercially sensitive databases in existence. As proposed, the repository would include private information such as the names of all customers, their account numbers, the types of accounts they opened and the times at which they opened accounts. It would also include the unique customer identification number for each customer that the SEC currently proposes to assign on the basis of social security or taxpayer identification numbers.[20] Moreover, each member of an exchange receiving an order from a customer, as well as every exchange and securities association that goes on to handle the order, must add its own unique identifier to each report it sends to the central repository.[21] These data submissions would undoubtedly help the SEC create a blueprint for reconstructing significant market events,

[20] *Id.* at 32,556.

[21] *Id.* at 32,573.

as well as aid efforts to track down broker-dealers and other parties who aided wrongdoing.[22] However, these reports, if used by the wrong parties or with the wrong intentions, could harm investors and traders by giving predatory market participants intimate and proprietary information about such investors' strategies. For example, a customer who is attempting to unwind a large position may be unable to do so as planned if knowledge about his plans is disseminated to other broker-dealers.

SROs should not be able to access data in the central repository about potential competitors, or at least should not be able to do so without proper certifications and safeguards to ensure the appropriate use of any requested information. The increased competition among the securities markets amplifies such concerns. Broker-dealers increasingly compete directly with exchanges for customers' order flow. Exchanges also compete with one another. Security protections are necessary to provide comfort that access is for legitimate regulatory purposes rather than competitive reasons.

To ensure that data in the central repository is not misused, SIFMA believes the SEC should restrict the scope of data that SROs can access. SROs should only be able to access order information and other data about their members for regulatory purposes, and exchanges should only be able to view information about transactions conducted on their exchanges. Only the SEC should be able to access all of the data in the consolidated audit trail, and only for critical regulatory purposes. By restricting the type and amount of data in the consolidated audit trail repository that organizations can access, the SEC would reduce the possibility of data being exploited or mined for a competitive advantage rather than used for genuine regulatory purposes.

As previously discussed in this letter, real-time reporting raises numerous concerns, particularly concerns related to confidentiality. First, if the information in the consolidated audit trail is required to be reported on a real-time basis, then security concerns about improper use of submitted data are magnified at every stage of the processing of an order. Each member of an exchange who originates an order or receives one from a customer has to include a unique identifier in each report it sends to the central repository for a reportable event.[23] When customer order information is passed along in real time to other broker-dealers and members on various exchanges, it can be viewed at numerous points on a real-time basis, multiplying the opportunities to mine and exploit that information. Second, real-time data can be analyzed in many ways to divine an investor's objectives through real-time analysis programs. These types of handoffs are even more common in the options markets, where orders are frequently routed through consolidators and third parties. Thus, it would be extraordinarily expensive for exchanges and SROs, let alone

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[22] *Id.*

[23] *Id.*

broker-dealers, to create adequate information security measures to protect client information if real-time reporting is required. Eliminating the real-time reporting requirement would mitigate client confidentiality concerns.

Finally, the SEC should specify the front-end system it would use to access the consolidated audit trail data in the central repository and for what purposes it would use the data. So far, the SEC has not specified how the central repository for the consolidated audit trail data would be operated or how the data stored in the central repository would be used to aid regulation. The SEC should clearly enumerate specific regulatory uses for the consolidated audit trail as well as the system that would serve as the central repository. If the SEC explained how the consolidated audit trail data would be used and stored, it would reassure investors and broker-dealers that the consolidated audit trail system would provide for a more fair and orderly market and assuage concerns about compromised confidentiality.

VI. Provide Guidance on Certain Items Left Unaddressed in the Proposal

While the Proposal provides significant explanation and direction, SIFMA believes that certain key issues related to the consolidated audit trail that merit consideration were left unaddressed. These issues concern foreign traders, funding for the consolidated audit trail, the newly created Office of Financial Research and the standardization of security symbols.

A. Foreign Traders

The SEC should clarify how the consolidated audit trail system would deal with foreign traders. Foreign entities, such as foreign broker-dealers, may refuse to identify their customers to domestic broker-dealers due to stricter privacy laws in their countries. The proposed consolidated audit trail rule does not explain what domestic broker-dealers should do in such cases in order to comply with their reporting requirements. If domestic broker-dealers are forced to refuse such orders from customers, that would be an unfair penalty to broker-dealers and may push trading activities offshore. This not only would be harmful to the U.S. markets, but would also hinder the SEC's goal for the consolidated audit trail to provide a comprehensive view of trading. The SEC should consider providing some type of limited exemption that would allow broker-dealers to process such trades given that many foreign broker-dealers are already regulated in their home countries. This approach would be consistent with the recent financial regulatory reforms that provide limited exemptions for foreign companies from new reporting requirements.

B. Funding

SIFMA believes that the SEC needs to specify the new sources of funding for the consolidated audit trail system. The SEC has estimated that the consolidated audit trail

would cost $4 billion to implement and $1.7 billion in annual ongoing costs.[24] SIFMA believes that the SEC's estimate of the costs required to create and operate a consolidated audit trail system are too low. However, it would be difficult for SROs to fund the consolidated audit trail system even if the costs are in line with SEC estimates. SROs have uneven sources of revenue and limited abilities to impose fees on members. If the SEC maintains that SROs must pay to construct and maintain the consolidated audit trail system, it may be forced to raise or eliminate the caps it has on transaction fees on exchanges. That move would give SROs more flexibility in obtaining money to pay for the new system. It would, however, resurrect the distortions caused by high transaction fees, potentially increase the use of flash orders, if allowed, and discourage trading activity.

C. Office of Financial Research

The SEC should also consider how the new Office of Financial Research would impact the reporting methods imposed by the consolidated audit trail. The Dodd-Frank Wall Street Reform and Consumer Protection Act establishes a new Office of Financial Research ("OFR")[25] that will have broad authority to collect and share data from companies and agencies.[26] The OFR can collect information from "member agencies, commercial data providers, publicly available data sources, and financial entities."[27] The OFR introduces further data security concerns. Although it is required to maintain the confidentiality of information submitted to it, such information is subject to Freedom of Information Act ("FOIA") requests.[28] This differs from the protection that the law affords to information provided by investment advisers to the SEC, which is excluded from FOIA requests in all cases.[29] SIFMA therefore urges the SEC to clarify how the broad data collection powers given to the OFR, as well as its power to require standardized reporting of data by agencies,[30] would affect the submission and security of consolidated audit trail data. Any information provided to the central repository should not have to be provided to the OFR again or in a different format.

The OFR also is required to prepare and publish a publicly accessible financial company reference database and a financial instrument reference database.[31] While neither database

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[24] Consolidated Audit Trail, 75 Fed. Reg. at 32,601-602.

[25] Dodd-Frank Wall Street Consumer Protection Act, Title I § 152.

[26] *Id.* §§ 153-4.

[27] *Id.* § 154(a)(1)(A).

[28] *Id.* § 112(d)(5)(C).

[29] *Id.* § 404(b)(7)(B).

[30] *Id.* § 153(a)(2).

[31] *Id.* § 154(b)(2)(A).

is set out in detail in the Dodd-Frank Act, a predecessor bill would have required that the financial company database include a comprehensive list of financial entities that may be counterparties to financial transactions or referenced in the contractual structure of a financial instrument. For each financial entity, the database would have included "but not be limited to a unique identifier, and sufficient information to differentiate the entity from every other entity, including an exact legal name and an address for each company, and an exact legal name and a social security number for each American citizen."[32] The larger financial instrument reference database was to include a comprehensive list of unique financial instruments. For each financial instrument, the database would have "include[d] a unique identifier and a comprehensive description of the contractual structure of the instrument as well as all express terms governing the interpretation and implementation of the contract, including jurisdiction, force majeure, and dispute resolution."[33] By "contractual structure," the bill contemplated the inclusion of the financial and economic obligations and rights, "both express and implied," established among all of the counterparties having identified roles in the contract, including advisors, principals, trustees, custodians, guarantors, prime brokers, executing brokers, clearing brokers, and issuers of securities.[34]

SIFMA believes that the OFR may play an important role in standardizing data throughout the financial industry, with major repercussions for the consolidated audit trail. Such standardization is an important prerequisite of the consolidated audit trail. For example, we believe there should be a single security symbol for an NMS security, regardless of where it trades. The recent options symbol standardization completed earlier this year would provide a useful guide for this initiative. It would be extraordinarily unproductive to engage in naming conventions for securities and members, so that they have a single member identifier across different trading venues, only to have these displaced by the reference databases of the OFR. SIFMA believes that the SEC needs to carefully coordinate the data standardization issues necessary for the consolidated audit trail with the OFR.

Finally, we respectfully request that the SEC provide specific criteria on how certain real-world transactions would be treated for purposes of the consolidated audit trail. For instance, the SEC should specify how data would be reported on a covered security's owner, point of origin and other data. The SEC should also detail what type of information various parties to an order, such as introducing brokers, registered investment advisers with discretion, brokers with discretion and prime brokers, would have to supply.

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[32] National Institute of Finance Act, S. 3005, 110th Cong. § 3(7) (2009).

[33] *Id.* at § 3(8)

[34] *Id.*

Finally, the SEC should specify how the information on omnibus and DVP accounts would be handled in the consolidated audit trail.

* * * * *

SIFMA appreciates the opportunity to comment on the Proposal and commends the SEC for taking steps to enable effective cross-market monitoring and surveillance.

SIFMA supports the goals of a consolidated audit trail. The May 6th market events highlighted the need for a comprehensive mechanism for market surveillance to provide the SEC and the SROs with more timely and complete information. SIFMA believes, however, that the consolidated audit trail, as proposed, is too ambitious in scope and should be more finely tailored in a risk-based manner to the surveillance needs of the SEC and the capabilities of broker-dealers, SROs and exchanges. In addition, the consolidated audit trail should leverage an existing audit trail, such as OATS, for its platform to minimize costs and implementation time.

We would be pleased to discuss the proposed rule and our comments in greater detail with the SEC and its staff. If you have any comments or questions, please do not hesitate to contact me at (202) 962-7386 or at jmchale@sifma.org.

Sincerely,

James T. McHale
Managing Director and Associate General Counsel
SIFMA

cc: Mary Schapiro, Chairman
Luis Aguilar, Commissioner
Kathleen Casey, Commissioner
Troy Paredes, Commissioner
Elisse Walter, Commissioner
Robert Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets
Rebekah Liu, Special Counsel, Division of Trading and Markets
Jennifer Colihan, Special Counsel, Division of Trading and Markets
Leigh Duffy, Attorney-Adviser, Division of Trading and Markets

Exhibit E - Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (Mar. 21, 2011) (SIFMA's comments on the recommendations of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues)

sifma

Invested in America

March 21, 2011

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File No. 265-26; Joint CFTC-SEC Advisory Committee Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to offer comments on the recommendations of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues (the "Committee") for regulatory action by the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC") (collectively, the "Commissions") in the wake of the so-called "flash crash" of May 6th, as set forth in their report entitled "Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010" (the "Report").[2] SIFMA believes that the Commissions have done an admirable job of responding to the challenges presented by the May 6th flash crash, and we applaud the Committee's efforts to continue to seek appropriate regulatory responses to the events of May 6th.

As discussed in more detail in Section B below, SIFMA supports the Commissions' efforts to date and recommends certain enhancements to existing initiatives and proposals under consideration. With the implementation of these additional modifications, SIFMA believes that the Commissions will have addressed the primary market structure issues raised by the May 6th events. As a result, SIFMA does not believe that the Committee's recommendations for more dramatic and sweeping changes to the U.S. market structure, such as a trade-at rule, are warranted. In Section A below, SIFMA discusses the many issues raised by the Committee's more far-reaching recommendations.

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1 SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

2 Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010: Summary Report of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues (Feb. 18, 2011) (available at http://www.sec.gov/spotlight/sec-cftcjointcommittee/021811-report.pdf).

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A. Specific Comments

In its Report, the Committee proposes certain significant changes to the basic U.S. market structure, including, among other things, a trade-at rule with depth of book protection. As discussed below, SIFMA does not believe that such transformative measures are necessary or appropriate, particularly given their potential adverse consequences and the more targeted and effective actions already taken or being taken by the Commissions, as discussed in more detail in Section B.

1. Trade-At Rule with Depth of Book Protection

The Committee recommends that the SEC consider adopting a trade-at routing regime and requiring greater depth of book protection than today's top of book trade through protection.[3] SIFMA strongly opposes the concept of a trade-at rule as it would impact the current operation of the markets in a dramatic and adverse way. In particular, a trade-at rule would adversely affect investors and stifle competition and innovation, while imposing significant implementation costs on the markets.[4] Moreover, SIFMA believes that there is no evidence that the basic price discovery model of today's markets is inherently flawed. In fact, empirical data shows that today's markets are more efficient than ever before, with greater liquidity, faster executions, narrower spreads, lower transaction costs and more opportunities for size and price improvement, in particular for retail investors.[5] Instead, SIFMA believes that the pricing issues revealed by the events of May 6th are best addressed through targeted measures, such as the use of the limit up/limit down approach and the elimination of stub quotes, rather than a fundamental overhaul of the markets that may have significant adverse unintended consequences.

A trade-at rule would have significant adverse consequences for investors, and retail investors in particular. Retail investors are well-served by the ability of their broker-dealers to determine the best manner in which to execute their orders. Internalization practices permit broker-dealers to offer immediate executions, size and price improvement, lower market impact and very low commissions. These practices would be negatively impacted by the proposed trade-at rule. For example, broker-dealers executing orders internally currently may provide a customer with faster, guaranteed executions along with opportunities for price improvement. By contrast, a trade-at rule might instead require that same order to be routed away, both slowing the execution of the customer's order and potentially causing the customer to miss the market and

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[3] Recommendation 12, Report at 13. As the Committee notes, under a trade-at regime, "orders must be routed to one or more markets with the best displayed price. Note that in such a "trade at" regime venues would be able to retain and execute any order by improving the current price." Report at 12.

[4] Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: Concept Release on Equity Market Structure, at 12-14 (Apr. 29, 2010) (available at http://www.sec.gov/comments/s7-02-10/s70210-167.pdf) ("SIFMA Comment Letter on Concept Release").

[5] See James J. Angel, Lawrence E. Harris, Chester S. Spatt, Equity Trading in the 21st Century, at 5 (Feb. 23, 2010) (available at http://www.knight.com/newsRoom/pdfs/EquityTradinginthe21stCentury.pdf) ("Equity Trading Study").

lose the opportunity for price improvement. The Report correctly notes that the markets currently are experiencing a high level of order cancellation rates. If the SEC were to adopt a trade-at rule, market participants would be required to chase the same orders that the Committee notes as subject to high cancellation rates, thereby putting the investor at risk of no execution or an execution at a worse price. In addition, a broker-dealer routing an order to an away trading center may well incur additional costs in the form of fees for accessing the liquidity of the away market. These fees, ultimately, may be passed on to the end user customers.

A trade-at rule also may be harmful for investors seeking to manage the impact of their trading on the market price they ultimately receive in transactions. Routing under a trade-at rule may well increase the likelihood of information leakage, signaling to other market participants the possibility of additional order flow at a non-displaying trading venue, for example, thereby disrupting attempts of investors to reduce implicit costs associated with larger orders. Moreover, with the proposed trade-at rule, the risks of additional information leakage would not be rewarded with a better price, as is the case with the current Order Protection Rule ("OPR"). While routing occasioned by the OPR involves some risk of information leakage, this risk is ameliorated somewhat by the fact that the routed order receives a *better* price as a result of the routing than otherwise would be the case, as well as by promotion of the regulatory policy of not allowing a *better* priced limit order to be bypassed. This benefit would not be the case under the proposed trade-at rule; instead, customers would incur all of the risks noted above in exchange for a market price that their own broker-dealer was willing to give them at the outset. In addition, investors who prefer not to have their orders displayed or routed could miss execution opportunities should potential contra-side liquidity have to be routed away to comply with a trade-at rule. This has the potential to be particularly problematic in highly liquid securities in which the quote is in a constant state of flux.

With the introduction of a trade-at rule that effectively dictates the manner in which broker-dealers must trade, competition with respect to other best execution factors – such as market depth, reliability, and liquidity guarantees – would fall largely by the wayside. As a result, a trade-at rule would stifle innovation, making it less feasible for new business models to develop, to the detriment of all investors. Indeed, it is the discretion afforded to broker-dealers in determining how best to execute orders that has put exchanges in healthy competition with ATSs and over-the-counter ("OTC") market makers over the last decade; without it, we would not have seen the exchanges' dramatic improvements in fees, speed, reliability, and customer service in recent years. Correspondingly, price competition among trading centers would be significantly hindered by a trade-at rule. A trade-at rule would require certain quotes to be hit in various trading centers, which in turn would reduce the incentive for trading centers to provide lower cost executions by, for example, lowering access fees.

The Committee has noted, appropriately, that a change in routing associated with a trade-at rule "may entail substantial costs with respect to technology and implementation."[6] SIFMA believes that the cost to change the routing technology would be more than substantial, and notes

[6] Report at 12.

that they would have to be absorbed shortly after the industry has finished its technology changes to implement Regulation NMS. Moreover, a trade-at rule would likely lead to a deluge of additional message traffic and increased incidence of flickering quotes. The added explicit costs to trading centers and broker-dealers (not to mention the potential costs to investors described above) would likely be significant, and would clearly outweigh any of the Committee's anticipated benefits of a trade-at rule.

Finally, a trade-at rule would extend well beyond the OPR in its clear preference for investors who display orders over investors who decide it is in their best interest not to display some or any of their orders – even if they may be willing to execute at the same price as the displayed markets. In this respect, a trade-at rule, particularly if it is paired with greater protection of depth-of-book, comes very close to a consolidated limit order book or "CLOB." Both would negate the competitive benefits of dispersed order flow and competition among multiple markets, and also would unnecessarily impede investor choice. We note that the SEC has considered a CLOB in the past and determined that such restrictive trading measures were unnecessary.[7]

2. Internalized or Preferenced Orders

In a topic closely related to the trade-at rule, the Committee expressed concern about the impact of the growth of internalizing and preferencing activity on the incentives to submit priced order flow to public exchange limit order books. As a result, the Committee recommends that the SEC consider whether to require material price improvement for internalized or preferenced orders, and/or require such internalizing or preferencing firms to execute some material portion of their order flow during volatile market periods.[8] These proposals would drastically change current order handling practices of broker-dealers. SIFMA continues to believe that internalization and preferencing provide genuine benefits to the markets and their participants without detracting from the overall vibrancy of the public, displayed markets.[9] Therefore, SIFMA strongly opposes either proposed requirements.

As discussed in more detail above, internalized executions provide investors – in particular, retail investors – with a variety of benefits, including immediate executions, size and price improvement, lower market impact and very low commissions, mainly because broker-dealers retain some level of discretion over the order execution process. Moreover, certain orders submitted that are not executed immediately must be displayed via the consolidated quotation system, thereby furthering public price discovery. Given these clear benefits to investors afforded by internalization and preferencing, SIFMA believes that the Commissions

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7 For example, the SEC considered and rejected a CLOB in its rulemaking proceedings regarding Regulation NMS. *See* Securities Exchange Act Rel. No. 51808 (June 9, 2005).

8 Recommendation 11, Report at 12.

9 *See* Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: Market Structure Roundtable, at 8-9 (June 25, 2010) (available at http://www.sec.gov/comments/4-602/4602-31.pdf) ("SIFMA Comment Letter on Market Structure Roundtable"); SIFMA Comment Letter on Concept Release at 11-12.

would need significant evidence that such practices, in fact, impair price discovery or execution quality. SIFMA does not believe that any studies conclude that such drastic measures are warranted. Indeed, a recent study concluded the following:

> Virtually every dimension of U.S. equity market quality is now better than ever. Execution speeds have fallen, which greatly facilitates monitoring execution quality by retail investors. Retail commissions have fallen substantially and continue to fall. Bid-ask spreads have fallen substantially and remain low, although they spiked upward during the financial crisis as volatility increased. Market depth has marched steadily upward. Studies of institutional transactions costs continue to find U.S. costs among the lowest in the world.[10]

Moreover, we note that, by protecting the top of book of trading centers, the OPR is an effective supplement to the duty of best execution in policing execution quality.

Therefore, SIFMA believes that internalization benefits investors of all sizes, both large and small, and has not adversely impacted the quality of the markets. As such, we believe the cost of the proposed changes to internalization practices to investors would far outweigh any benefits and, therefore, should not be implemented.

3. Peak Load Pricing Model

In its Report, the Committee recommends that the Exchanges modify their current maker-taker pricing models by incorporating a "peak load" pricing feature.[11] The Committee posits that such "peak load" pricing would encourage the provision of liquidity in periods of high volatility. Although SIFMA agrees with the SEC's decision to evaluate the effect of maker-taker pricing on market quality,[12] SIFMA disagrees with the Committee's proposal to adopt "peak load" pricing. Not only would "peak load" pricing, in practice, fail to encourage liquidity in active or volatile market conditions, but it would introduce additional new problems to the markets.

First and foremost, SIFMA does not believe that "peak load" pricing would provide an adequate incentive to provide liquidity at the times when the markets would most need it. As the Committee recognizes, "in many periods of sudden and extreme volatility trading uncertainties may result in active traders withdrawing no matter what the incentives."[13] After all, the risk of significant trading losses in volatile markets far outweighs any savings offered by a change in fees or increase in rebates.

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10 Equity Trading Study at 5.

11 Report at 8-10.

12 SIFMA Comment Letter on Concept Release at 15-16.

13 Report at 9.

Second, SIFMA believes that "peak load" pricing ultimately would hurt retail investors. In order to encourage additional liquidity in active or volatile markets, the exchanges would need to increase rebates paid to liquidity providers. We believe it highly likely that, to continue to make a profit, the exchanges would increase access fees for liquidity takers. These fees, ultimately, may well be passed on to retail investors. Thus, increased access fees may drive more investors to trade at internalizing firms.

Third, although the proposal may have some academic appeal, SIFMA believes that the proposal introduces a variety of practical implementation difficulties. For example, it will be difficult for the markets to identify prospectively when peak loads may occur, and even more difficult for market participants to plan any business changes based on when peak load periods occur. In addition, such pricing would lead to substantial additional data message traffic. On a real-time basis, markets would need to identify "peak load" trading periods, and communicate pricing changes for those "peak load" periods.

Finally, SIFMA previously has expressed concern that maker-taker pricing distorts the economic spreads for stocks.[14] For instance, for stocks trading in penny increments, a taker fee can represent up to a 50-60% mark-up from displayed prices. The introduction of "peak load" pricing would exacerbate this distortive effect on stock prices even further. Therefore, SIFMA believes that the Commissions should address the liquidity issues in volatile markets directly through the use of circuit breakers and limit up/limit down protections (as discussed below) rather than through complicated fee structures that are unlikely to incent market participants to provide liquidity at the most critical times.

4. Market Making Incentives

In its Report, the Committee also recommends the use of incentives, such as differential pricing or preferential co-location provisions, to encourage high frequency traders and other persons who engage in market making strategies to regularly provide buy and sell quotations that are reasonably related to the market.[15] The Committee reasoned that such incentives may enhance liquidity, particularly in those moments when it is most needed. As an initial matter, SIFMA notes that not all high frequency trading strategies involve market making activity, an important consideration with respect to the scope of any regulatory initiatives. More importantly, SIFMA does not believe that incentives such as those discussed above would have the intended effect. As past experience with market maker quoting obligations highlight, quoting requirements do not operate to ensure liquidity, particularly in volatile markets; the risk of quoting can be too great to market participants.[16] Moreover, SIFMA believes that a significant issue in the liquidity drought on May 6th was the lack of confidence of market participants in published market data. Without reliable market data, firms will not be willing to commit capital

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[14] SIFMA Comment Letter on Concept Release at 15-16.

[15] Recommendation 9, Report at 10-11.

[16] Report at 10.

to the markets regardless of the incentives offered by trading centers. Therefore, SIFMA recommends that the SEC consider how to better ensure the quality of market data and generally seek other ways to ensure that liquidity does not flee the market, rather than looking to market makers and others who engage in market making strategies to hold back the floodgates during volatile trading.[17]

5. Allocation of Order Cancellation Costs

In its Report, the Committee highlighted the disproportionate impact that high frequency trading has on message traffic and market surveillance costs and, as a result, recommended the fair allocation of these costs to the responsible market participants.[18] Specifically, the Committee proposed imposing on those market participants with high message cancellation rates a cross-market fee based on the ratio of order cancellations to actual transactions effected by such market participant. SIFMA agrees that a high level of order cancellations does increase message traffic and surveillance costs. Conceptually, we also agree that the proposed allocation of those costs to responsible market participants is appropriate. SIFMA notes, however, that implementation details would need to be carefully crafted, including, but not limited to, determining what constitutes an order cancellation rate sufficiently high enough to justify an allocation of costs, what costs should be allocated, how those costs should be equitably allocated, and what should be done with any fees collected.

6. Reporting of Market Imbalances and Other Liquidity Information

In its 13th Recommendation, the Committee urges the Commissions to consider reporting requirements for measures of liquidity and market imbalances for large market venues. The Committee reasons that the provision of such market information may generate a response from market participants to liquidity imbalances.[19] SIFMA believes that requiring such reporting raises practical implementation issues, as well as concerns about adversely impacting competition among markets. In addition, SIFMA believes that, in considering any such reporting requirements, the Commission also should analyze how the new reporting requirements would or should affect consolidated market data.[20] If, however, the Commission determines that such real-time information is feasible, valuable and not anti-competitive, SIFMA recommends that such market data be made available to all market participants on terms that are fair and reasonable and at the same time. In times of market imbalance, no market participant should have an information advantage over others.

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17 SIFMA Comment Letter on Market Structure Roundtable at 7.

18 Recommendation 10, Report at 11.

19 Report at 13-14.

20 For example, SIFMA believes that the Commission should take steps to require or incentivize improvement in consolidated market data speed and depth without sacrificing the improvements made regarding the speed and depth of direct market data.

B. General Comments

In its Report, the Committee expresses support for certain current initiatives of the regulators, and recommends enhancing other initiatives currently proposed or being considered by the regulators. In previous comments on these topics, SIFMA expressed general support for these efforts and, in some cases, provided additional guidance as to how to further improve the regulatory proposals. More specifically:

- Single Stock Pauses.[21] Like the Committee, SIFMA agreed with the Commission on the need to implement single stock pauses/circuit breakers for the Russell 1000 stocks and actively traded ETFs. Also like the Committee, SIFMA believes that the protections afforded by the pauses should now be extended to all securities. Moreover, SIFMA recommends that the SEC should continue to work with industry participants to explore how circuit breaker trading pauses should be treated across related markets, including the options and futures markets.[22]

- Limit Up/Limit Down.[23] SIFMA supports the implementation of a limit up/limit down approach, and has provided detailed comments as to how such an approach might be implemented.[24] SIFMA agrees with the Committee's suggestion that the Commissions clarify whether securities options exchanges and single stock futures exchanges should continue to trade during any equity limit up/limit down periods.

- Clearly Erroneous Rules.[25] SIFMA supports the SEC's efforts to curtail the markets' discretion in breaking erroneous trades through the SROs' adoption of new clearly erroneous trading rules.[26] We urge the SEC, the exchanges and FINRA, however, to continue to work to ensure uniformity and consistency in the application of these clearly erroneous rules. In addition, we believe that the options exchanges should handle erroneous trades in a manner consistent with the equity markets. We note, however, that if the limit up/limit down approach is adopted, erroneous trades should not occur outside the relevant trading band, thus making the clearly erroneous rules less critical.

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21 *See* Recommendations 1(a) and 2, Report at 3-4.

22 SIFMA Comment Letter on Market Structure Roundtable at 2.

23 Recommendation 3, Report at 5.

24 SIFMA Comment Letter on Market Structure Roundtable at 3; Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: SIFMA Proposal to Prevent Price Swings Due to Liquidity Gaps (Oct. 12, 2010) (available at http://www.sec.gov/comments/265-26/265-26-42.pdf).

25 Recommendation 1(b), Report at 3.

26 SIFMA Comment Letter on Market Structure Roundtable at 5; Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: Clearly Erroneous Executions (July 26, 2010) (available at http://www.sec.gov/comments/sr-bats-2010-016/bats2010016-8.pdf).

- Stub Quotes.[27] SIFMA commends the SEC for its recent efforts to have the exchanges implement minimum quoting requirements for market makers that effectively eliminate their ability to employ stub quotes.[28]

- System-Wide Circuit Breakers.[29] SIFMA agrees with the Committee regarding the need to update the system-wide circuit breakers to work more appropriately in today's trading environment.[30] In this regard, SIFMA believes that any modifications to such circuit breakers should be coordinated between the securities and futures markets.[31]

- Naked Access.[32] As the SEC considered its "naked access" rulemaking, SIFMA expressed support for the principles of pre- and post-trade controls and procedures in sponsored access arrangements.[33]

- Consolidated Audit Trail.[34] SIFMA fully supports the SEC's objective of providing timely access to a robust, cross-market audit trail for NMS securities and ultimately other securities. We continue to question, however, the need for real-time reporting of the entire set of data elements in the SEC's consolidated audit trail proposal, and believe that reporting on a T+1 (or, in some cases, later) basis should satisfy the SEC's stated regulatory objectives more efficiently and be consistent with an appropriate cost-benefit analysis.[35]

- Coordination of Securities and Futures Markets. The Committee makes two recommendations specifically related to the CFTC's oversight of the futures markets – Recommendation 4 regarding a second tier of pre-trade risk safeguards and Recommendation 7 regarding disruptive trading practices. In considering these proposals, SIFMA urges the CFTC to coordinate with the SEC to ensure consistent

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27 Recommendation 1(c), Report at 4.

28 SIFMA Comment Letter on Market Structure Roundtable at 4.

29 Recommendation 5, Report at 6.

30 For example, instead of the current approach to system-wide circuit breakers, the Commissions could evaluate whether the system-wide circuit breakers should be triggered when a certain percentage of individual stocks are subject to a trading pause.

31 SIFMA Comment Letter on Market Structure Roundtable at 4.

32 Recommendation 6, Report at 7.

33 Letter from Ann Vlcek, SIFMA, to Elizabeth M. Murphy, SEC re: Management Controls for Brokers or Dealers with Market Access (April 16, 2010) (available at http://www.sec.gov/comments/s7-03-10/s70310-56.pdf).

34 Recommendation 14, Report at 14.

35 Letter from James T. McHale, SEC, to Elizabeth M. Murphy, SEC re: Consolidated Audit Trail (Aug. 17, 2010) (available at http://www.sec.gov/comments/s7-11-10/s71110-63.pdf); SIFMA Comment Letter on Market Structure Roundtable at 11.

treatment of the equities and futures markets, and to work with industry participants to ensure the implementation of an efficient and effective approach.[36]

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SIFMA appreciates the opportunity to comment on the issues raised in the Committee's Report. SIFMA notes, however, that the Report does not discuss a variety of other important issues that SIFMA has discussed in recent comment letters, such as issues raised by co-location, access fees, market data quality and market center obligations.[37] We look forward to further discussions about the specific regulatory initiatives raised in the Report and otherwise with the Commissions and their staffs. If you have any comments or questions, please do not hesitate to contact me at 202-962-7300 or avlcek@sifma.org.

Sincerely,

Ann L. Vlcek
Managing Director and
Associate General Counsel
SIFMA

cc: Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
Kathleen L. Casey, Commissioner
Troy A Paredes, Commissioner
Elisse B. Walter, Commissioner
Robert W. Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets
Daniel Gray, Market Structure Counsel, Division of Trading and Markets

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36 Robert Pickel, ISDA and Kenneth Bentsen, Jr., SIFMA, to David A. Stawick, CFTC re: Antidisruptive Practices (Jan. 3, 2011) (available at http://www.sifma.org/issues/item.aspx?id=22840).

37 *See, e.g.,* SIFMA Comment Letter on Market Structure Roundtable and SIFMA Comment Letter on Concept Release.

Exhibit F - Letter from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, to Elizabeth Murphy, Secretary, SEC (June 22, 2011) (SIFMA's comments on the limit-up/limit-down proposal by various self-regulatory organizations)

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Invested in America

June 22, 2011

By Electronic Mail (rule-comments@sec-gov)
Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: File No. 4-631, Plan to Address Extraordinary Market Volatility Submitted to the Securities and Exchange Commission Pursuant to Rule 608 of Regulation NMS Under the Securities Exchange Act of 1934

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Plan to Address Extraordinary Market Volatility (the "Proposed Plan") Submitted to the Securities and Exchange Commission ("Commission" or "SEC") Pursuant to Rule 608 of Regulation NMS Under the Securities Exchange Act of 1934 ("Exchange Act") by various self-regulatory organizations ("SROs").[2] As noted in our comment letter to the Joint CFTC-SEC Advisory Committee,[3] SIFMA agrees that there is a need to consider measures to limit destabilizing price moves in the financial markets. Similar to our proposal to the Advisory Committee, the Proposed Plan would implement limit up-limit down mechanisms to prevent trades in NMS Stocks from occurring outside of specified trading price bands, as well as trading pauses to address more fundamental liquidity events in NMS Stocks.[4] Specifically, the Proposed Plan would require all trading centers, including those operated by participants of the Proposed Plan and their members, to establish, maintain and enforce written policies and procedures reasonably designed to comply with the limit up-limit down and trading

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1 SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

2 Exchange Act Release No. 64547, 76 FR 31647 (June 1, 2011)("Proposing Release").

3 Letter to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, dated October 12, 2010.

4 The Proposed Plan would be implemented as a one-year pilot program.

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pause requirements of the Proposed Plan.[5] We believe that the proposed limit up-limit down and trading pause pilot measures should help prevent extreme price swings and stock price dislocations that are caused by oversized marketable orders sweeping displayed liquidity to price levels not reasonably related to the value of the security. The Proposed Plan also should significantly reduce clearly erroneous, "busted" and adjusted trades. Therefore, we commend the SROs for their efforts in collaborating on the Proposed Plan.

While SIFMA supports the Proposed Plan as a general matter, we believe that certain changes should be made to enhance its effectiveness. There also are a number of areas in which regulatory clarification and guidance will be critical to the proper implementation of written policies and procedures by trading centers pursuant to the requirements of the Proposed Plan. For example, SIFMA believes that exclusions from the restrictions of the Proposed Plan are appropriate to permit trading that is not likely to exacerbate volatile market conditions. Similarly, given the liquidity normally attendant to the close of regular trading, and the importance of determining an orderly closing price for a security, the SROs should modify the Proposed Plan to permit trading without price bands or trading pauses near the close of regular trading. Regulatory guidance on the obligations of trading centers handling customer orders that may not be executed or displayed as a result of trading bands or trading pauses also will be necessary for the proper implementation of the Proposed Plan. More generally, the Commission and the SROs will need to coordinate to ensure that existing market safeguards, such as market-wide circuit breakers[6] and SRO clearly erroneous rules, will function as intended in their current state after implementation of the Proposed Plan or are appropriately modified to work in conjunction with the Proposed Plan, or, if no longer necessary in light of the Proposed Plan, are eliminated. SIFMA believes that it is important that guidance on these and other interpretive issues related to the Proposed Plan is provided to firms by the SROs and the Commission prior to implementation of the Proposed Plan. The Proposed Plan is complex, and interpretive guidance is necessary to ensure that the proposals will not inadvertently reduce market liquidity or otherwise introduce unintended and adverse consequences into the market. Ensuring that the functioning of the Proposed Plan is well understood by firms also will be critical to their ability to explain to investors – and retail investors in particular – how any new rules will impact their trading.

These and related issues are discussed below.

I. Modifications Necessary with Respect to the Proposed Plan

Transactions that Should be Excluded from the Proposed Plan. While SIFMA agrees that the Proposed Plan should be helpful in addressing extraordinary market volatility events, we also believe that trading that clearly cannot or is not designed to affect the volatility of the markets

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[5] Under Regulation NMS, "trading centers" generally include exchanges, alternative trading systems ("ATSs"), and broker-dealers executing orders internally. 17 C.F.R. § 240.600(b)(78).

[6] As previously noted to the Commission, SIFMA supports efforts to consider whether the current market-wide circuit breakers should be recalibrated to be more effective in today's fast paced electronic trading environment. Letter from Ann L. Vlcek, Managing Director and Associated General Counsel, SIFMA, to Elizabeth M. Murphy, Secretary, SEC (June 25, 2010)("Market Structure Roundtable Letter").

should be permitted whenever possible. For example, transactions that do not impact consolidated last sale prices should be excluded from the price band and trading pause provisions of the Proposed Plan. The Proposed Plan provides that the Reference Price[7] used to calculate the limit up-limit down price bands will be based on the average price of Eligible Reported Transactions for an NMS Stock over the preceding five minute window.[8] "Eligible Reported Transactions" include transactions that are eligible to update the last sale price of an NMS Stock.[9] SIFMA agrees that only transactions that may update the last sale price should be relevant for purposes of determining the Reference Price for an NMS Stock; however, we also believe the corollary principle: transactions that do not update the last sale price of an NMS Stock should be excluded from the prohibitions of the Proposed Plan. For example, under existing guidance, average price trades do not update the last sale price.[10] Whether excluded from last sale updates by virtue of provisions of the Consolidated Tape Association Plan or Nasdaq UTP Plan[11] or by SRO rules that assign certain trades "non-media" status,[12] by definition, such transactions will have no impact on the volatility of the market. As such, the Proposed Plan should not affect them and trading centers should be permitted to effect such trades as part of ordinary trading activity.

Transactions clearly entered without the capability to initiate or exacerbate market volatility similarly should be excluded from both the price bands and trading pause provisions of the Proposed Plan. Specifically, "benchmark trades" – trades that are executed at a price not based, directly or indirectly, on the quoted price for an NMS Stock at the time of execution and for which the material terms were not reasonably determinable at the time that the commitment to execute the order was made – pose little threat to the underlying goals and purposes of the Proposed Plan and should be excluded from its provisions, as they are from the restrictions of Rule 611 (the "Order Protection Rule" or "OPR").[13] Qualified contingent trades in which at least one component order is an NMS Stock, error correction transactions and so-called "underwater

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7 Capitalized terms used herein, unless defined otherwise, have the meaning ascribed to them in the Proposed Plan.

8 *See* Section V of Proposed Plan; Proposing Release at 31647.

9 Section I(A) of Proposed Plan.

10 Consolidated Tape System Output Multicast Input Specification at 102 (March 24, 2010).

11 The CTA and Nasdaq UTP Plans exclude a number of transactions from reporting to the tape, including: primary and secondary distribution; private placements under Section 4(2) of the Securities Act of 1933; trades at prices unrelated to the current market price (e.g., gift trades); odd-lot transactions; acquisitions in anticipation of exchange offers; off-exchange purchases pursuant to a tender offer; and purchases and sales of securities upon exercises of options at prices unrelated to the market. See Sections VI(b) and VIII(b) of the CTA and Nasdaq UTP Plans, respectively.

12 Whether submitted to FINRA for clearing and regulatory purposes, or solely for regulatory purposes, transactions that are not publicly reported should be excepted from the restrictions of the Proposed Plan.

13 *See* 17 C.F.R. § 240.611(b)(7).

stop" trades also are narrowly defined under the Commission's guidance,[14] and are effected for reasons unrelated to the current market price for a security.[15] These trades are excepted from the OPR and similarly should be excluded under the Proposed Plan as a means to permit continued trading activity that is not inconsistent with the Proposed Plan.

Trading at the Close. Notwithstanding the doubling of the price bands prior to the close each day under the Proposed Plan, SIFMA is concerned that the Proposed Plan will impede what otherwise would be a fair and accurate mechanism for determining an orderly closing price for a security. Given that liquidity often is highest at or around the close of trading, we believe that continuous trading – without the application of price bands or trading pauses – should be permitted for some period of time prior to the close of trading in NMS Stocks. Indeed, we note that, during Phase I of the Proposed Plan implementation, no price bands will be calculated and disseminated less than 30 minutes before the end of regular trading hours and trading shall not enter a Limit State less than 25 minutes before the end of regular trading hours. We believe that this approach should be taken with respect to the Proposed Plan generally.[16] It also is worth noting that the rules for both the NYSE and NASDAQ closing auctions rely on a valid bid/offer at 4:00 p.m. to "reprice" certain orders for inclusion in their closing process. At a minimum, the Commission should consider whether price bands and trading pauses are necessary at the close of trading based on its experience at the conclusion of Phase I of the pilot implementation of the Proposed Plan.

Should the Commission nonetheless determine that there is a need for an additional safeguard against volatility at the close, we suggest that this concern may be addressed through the application of the double-wide limit up-limit down price bands, without the need for any trading pauses during the last 10 minutes of trading. In all instances, the Commission should avoid any situation in which a pause may occur near the close of regular trading in a manner that does not permit an exchange to conduct an orderly reopening to establish a closing price for a stock (e.g., a trading pause that occurs at 3:57 p.m. ET).[17]

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[14] *See* Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS ("Rule 611 FAQs"), FAQ No. 3.12 (April 4, 2008)(qualified contingent trades); Rule 611 FAQs, FAQ No. 3.11 (error correction transactions); and Rule 611(b)(9) and Rule 611 FAQs, FAQ No. 3.10 (underwater stop transactions).

[15] In approving the exception from the OPR for qualified contingent trades, the Commission noted, among other factors, that such trades generally act as a stabilizing factor in the markets and contribute to market efficiency and price discovery. Exchange Act Release No. 54389 (August 31, 2006).

[16] The Commission has recognized the importance of permitting an orderly closing process in connection with other market volatility guards. Specifically, to avoid interfering with existing opening and closing procedures, the Commission determined to limit the application of the stock-by-stock circuit breaker pilot to the hours of 9:45 a.m. to 3:45 p.m. *See e.g.,* Exchange Act Release No. 12251 (June 10, 2010); as noted by the Commission, these circuit breakers currently are scheduled to expire on the earlier of August 11, 2011 or the date on which a limit up-limit down mechanism is adopted. Proposing Release at 31649-49.

[17] In this regard, the Commission should consider implications for closing options orders under circumstances in which an equities exchange conducts a closing rotation after 4:00 p.m. when the options exchanges have already closed.

Limit State Time Period. SIFMA also believes that the SROs should reconsider and amend the proposal so that the time period allotted under the Proposed Plan for an NMS Stock to exit a Limit State is reduced from 15 seconds to five seconds.[18] Under the Proposed Plan, when the National Best Offer is equal to the Lower Limit Band or a National Best Bid is equal to the Upper Limit Band for an NMS Stock, the Processor will distribute such National Best Bid or National Best Offer with a flag identifying it as a Limit State Quotation.[19] Once a stock has entered a Limit State, the Processor will cease calculating and disseminating price bands for the stock until trading exits the Limit State or there is an opening or reopening in the stock. Trading in an NMS Stock exits a Limit State if, within 15 seconds of entering the Limit State, the entire size of all Limit State Quotations are executed or cancelled. Once a stock has exited a Limit State, the Processor will resume calculating and disseminating limit up-limit down price bands. The purpose of the Limit State is to allow liquidity providers to refresh their quotations. In today's electronic markets, it takes significantly less than 15 seconds for liquidity providers to update their quotations. As a result, we believe that in the vast majority of instances Limit States will be exited within very short periods of time – likely within one second. As evidence of this, observe how quickly quotes recover in the vast majority of cases that have occurred under the current circuit breaker regime. In fact, if quotes do not refresh in a very short time period (i.e., under five seconds), it usually is indicative that there is something else preventing trading systems from automatically refreshing and likely involves conditions that should cause a pause.

Moreover, the longer the period allotted for exiting a Limit State, the greater the potential for uncertainty among market participants. For example, a long Limit State exit period may cause unnecessary uncertainty in the options markets, which are closely tied to the equity markets. It is not clear what options market makers will do when there is a Limit State in an NMS Stock underlying an option, but one response in the face of the uncertainty associated with a potential trading pause in the underlying stock may well be the widening of quotations on the associated option. Various options exchanges also could determine to halt trading in an option when there is a Limit State in the underlying NMS Stock. Similarly, the longer a potential Limit State, the more confusion likely to attend retail investors seeking execution of their orders.[20] We note that the similar mechanism in the futures markets – namely, the CME stop loss logic – provides for a five second liquidity replenishment period, and was found by both the Commission and CFTC staffs to have worked well during the May 6, 2010 flash crash. Therefore, we urge the Commission and the SROs to adopt a shorter period for the exit of Limit

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[18] Some SIFMA firms believe that a five second Limit State may be too long for some stocks, and suggest that the SROs and Commission consider a shorter Limit State based on the results from the pilot period for the Proposed Plan.

[19] Proposed Plan § VI.A.2.

[20] Reducing the time period between a Limit State and start of a trading pause not only would avoid investor confusion, but it also would help protect retail investors from ill-advised transactions during Limit States. We are concerned, for example, that retail investors, in particular, may unwittingly purchase or sell when a Limit State Quotation is in effect under circumstances in which there is a meaningful reason for an increase or decline in the market price for a security.

States in NMS Stocks.[21] At a minimum, we urge the SROs to ensure that the technology implementing this aspect of the Plan is highly configurable and to closely evaluate Limit State conditions early during the pilot of the Proposed Plan with a view toward reducing the 15 second Limit State period to five seconds.

Criteria for Exiting a Limit State. We also note that the Proposed Plan could result in the exit of a Limit State under circumstances in which there is not a new limit bid or offer. For example, if all of the quotations comprising a Limit State Quotation were cancelled without a new bid or offer that is executable (i.e., a bid or offer within the pricing band) being established, it appears that the Limit State period would nonetheless cease. In order to reestablish an orderly market, SIFMA recommends that the Proposed Plan require a new bid and a new offer that are executable before the expiration of a Limit State period. In the absence of a bid and offer, a trading pause may be a more appropriate manner in which to reestablish the market for an NMS Stock.

Order Handling Obligations. The Commission and the SROs must specify the obligations of broker-dealers and member firms handling "held" customer orders once the Proposed Plan has been approved. Specifically, under the Proposed Plan, trading centers must have reasonable policies and procedures to prevent the display of offers below the Lower Price Band and of bids above the Upper Price Band.[22] Also, when the National Best Bid is below the Lower Limit Band or a National Best Offer is above the Upper Limit Band, such bids and offers are not eligible for execution. The ability of broker-dealers to delay, reprice or reject held orders consistent with the Commission's limit order display rule,[23] as well as the best execution obligations of broker-dealers more generally in such circumstances, should be clearly set forth by regulators. Other rules similarly based on the existence of an executable NBBO – such as the OPR and the market center execution quality statistics of Rule 605 – also will need to be considered and addressed by regulators given that certain bids and offers will be non-executable under the pricing band provisions of the Proposed Plan.[24] The Proposed Plan will preclude the calculation and dissemination of an NBBO when a Limit State is in effect for an NMS Stock, also impacting compliance with Rules 605 and 611. SIFMA looks forward to working with the SROs on these and other implementation issues pertaining to the Proposed Plan.

Clearly Erroneous Rules. The adoption of the Proposed Plan also should cause the reevaluation of SRO clearly erroneous trade rules. SIFMA has recognized the need for uniform

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[21] SIFMA recognizes that less liquid securities may require a longer period of time to exit a Limit State. Thus, the Commission could impose a five second Limit State period for more liquid NMS Stocks and a 15 second Limit State period for less liquid NMS Stocks. As noted, the SROs and the Commission should evaluate the appropriate time period for a Limit State based on the results of the pilot.

[22] Under the Proposed Plan, exchanges that are Plan Participants must adopt rules requiring their members operating trading centers to comply with the provisions of the Proposed Plan.

[23] *See* 17 C.F.R. § 240.604.

[24] SIFMA believes that periods in which there is a non-executable bid or offer in an NMS Stock should be excluded from Rule 605 data.

rules that provide consistency with respect to when it is appropriate for markets to break trades.[25] However, we anticipate that the use of these rules will significantly decline once the limit up-limit down price bands are in effect. SIFMA appreciates, however, that extraordinary circumstances may arise that warrant the exercise of discretion by SROs to break trades based, for example, on incorrect market data – even if such trades fall within a particular price band that, itself, is based on bad market data. Similarly, clearly erroneous rules may still be necessary with respect to transactions effected outside of normal trading hours. At a minimum, however, SROs should amend their rules so that the strong presumption is that trades executed within the price band are not subject to "busting" or other adjustments. We also note that, unlike the equity exchanges, the options exchanges do not have consistent clearly erroneous rules. In light of this, consideration should be given to how disputes regarding options transactions that may occur during a trading pause will be resolved.

Plan Governance. The Proposed Plan's governance structure should be broadened and made more transparent. As part of Regulation NMS, the Commission mandated the establishment of non-voting advisory committees as part of the CTA Plan, Nasdaq UTP Plan and CQ Plans.[26] Those governance changes give interested parties the ability to submit their views to plan operating committees on a variety of issues related to the plans, including any new or modified fee, product or operating program.[27] Current NMS plan advisory committees are comprised of various segments of the broker-dealer industry (e.g., retail broker-dealers, institutional broker-dealers and alternative trading systems), data vendors and investors.[28] SIFMA recommends the creation of such an advisory committee to supplement the operating committee set forth in Section V of the Proposed Plan. To encourage transparency, minutes of Plan committee meetings should be required and made available to interested parties.

Need for an SEC Rule? Some SIFMA members believe that the limit price bands and trading pause provisions would be better implemented pursuant to an SEC rule. The Proposed Plan will have a market-wide impact on trading. As such, the ongoing and direct involvement of the Commission will be important to the efficient and effective resolution of interpretive questions relating to the Proposed Plan and the reasonableness of policies and procedures adopted by trading centers. In this regard, we note that the Proposed Plan is analogous to Regulation NMS, which is a Commission rule. Similarly, some members are concerned about the circumstances under which one or more exchange participants might later seek and obtain permission from the Commission to withdraw from the Plan, as contemplated by Section IX of the Proposed Plan.

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25 Market Structure Roundtable Letter.

26 *See* Exchange Act Release No. 51808 (June 29, 2005)(adopting Regulation NMS, including changes to NMS Plan governance structures).

27 *Id.*

28 *See* CTA Plan, Section III(e).

II. Other Considerations Relating to the Proposed Plan

Trading at the Open. Greater clarity is needed with respect to how the Proposed Plan may impact the opening of daily trading.[29] Based on the Proposed Plan, it appears that there may be no limit up-limit down price bands in effect for an NMS Stock during the first five minutes of trading if the Opening Price for the stock does not occur on the Primary Market within that period because there will be no Reference Price under such circumstances. It would be helpful for the Commission and the SROs to clarify whether this is, in fact, the case and to specify whether there are any other considerations with respect to how trading centers may trade before a price band is established. Indeed, some SIFMA members favor amending the Proposed Plan so that it does not apply from 9:30-9:35 a.m. so that uninhibited price discovery may take place at the open.

Price Band Thresholds. Although SIFMA is in general agreement with the proposed five and ten percent price bands for Tier 1 and Tier 2 NMS Stocks,[30] respectively, under the Proposed Plan we note that, in some instances, actual pricing bands may be below these levels. For example, the pricing band for a Tier 1 NMS Stock could be as low as four percent above and below the prevailing market price. Specifically, under the Proposed Plan, a new Reference Price will only be disseminated if there is a change of one percent or more in the Pro-Forma Reference Price[31] over the then prevailing Reference Price. As a result, if the market price for an NMS Stock moves by less than one percent, the pricing bands will not change and, as a result, the limit up and limit down prices will be closer to four percent than five percent over the prevailing market price.[32] We appreciate that this result may be unavoidable absent a determination to continually update the Reference Price anytime there is a move in the price of the associated NMS Stock, and SIFMA does not advocate such an approach. However, the relationship of the

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29 Some member firms have noted issues with the open and close of trading in light of the current stock-by-stock circuit breaker pilot programs, and thus urge the Commission to carefully consider how to minimize disruptions to the open and close of trading once the Proposed Plan has been adopted.

30 The SROs and the Commission also should consider whether the trading characteristics of certain NMS Stocks present unique issues in terms of the pricing bands. In some instances involving particularly illiquid stocks, the price bands disseminated under the Proposed Plan, which will be calculated based on the average of Eligible Reported Transactions over the preceding five minute period, may be within the bid-offer spread for the stock. Thus, normal trading in such stocks would be precluded under the Proposed Plan. For example, as one SIFMA member firm noted, on June 10, 2011, the NBBO in TBOW, which has an average daily volume of approximately 28,000 shares, was 2.45 - 2.80 from 9:52:14 to 10:00:15, with a last sale price during this period of 2.45. Using a 10 percent price band, the 2.80 best offer would have been outside the 10 percent upper band (2.69). This firm has indicated that, based on its preliminary research, this may happen quite frequently (e.g., hundreds of times) throughout the day in low priced stocks. SIFMA suggests that such illiquid securities might be identified by comparing the average daily trading volume of such securities to their public float. Securities meeting an appropriately established threshold indicating that they are illiquid should either be excluded from the Proposed Plan or subject to a pricing band calculation based on the spread of such stocks.

31 Under the Proposed Plan, Pro-Forma Reference Prices will be calculated by the Processor on a continuous basis.

32 For example: At T1: Reference Price = $100/Price Band = 95/105. At T2, the price of the NMS Stock moves to $100.99. The Price Band remains at 95/105 notwithstanding that this is less than five percent over/below the current market price.

price bands to prevailing market prices should be taken into account in evaluating the appropriate price band threshold percentages at the beginning and conclusion of the pilot period.

We also note that it is unclear how intra-day changes in the price of an NMS Stock will affect the applicable price bands under the Proposed Plan. Specifically, price bands applicable to Tier 1 and Tier 2 NMS Stocks will vary based on whether a stock is priced at or above one dollar per share. The SROs should clarify how price bands will apply to stocks with prices that cross the one dollar threshold during intra-day trading. For surveillance and operational purposes, SIFMA member firms believe that the price band for an NMS Stock on any given day should not vary during that day and, instead, should be determined by the prior day's closing price for the stock, or through some similar objective methodology.

Need for SRO Rule Changes or Guidance. In addition to our comments above with respect to the likely impact of the Proposed Plan on Commission and SRO rules tied to the NBBO, guidance also is needed with respect to the impact of the Proposed Plan on other SRO rules and practices. For example, SIFMA believes, consistent with earlier suggestions by the Commission, that with the adoption of the market-wide price bands and trading pause provisions of the Proposed Plan, the market volatility guards of individual SROs are no longer necessary and should be repealed.[33] Permitting exchanges to invoke different approaches to markets experiencing excess volatility, in our view, will not be as effective as a market-wide approach.

SROs will need to adopt rules specifying how they plan to handle orders that have been routed to them when such orders present display or execution issues under the Proposed Plan. Will such orders be rejected back to member firms? Will they be adjusted such that they may be displayed or executed consistent with the pricing bands? To the extent that new order types may be considered to address these issues, SIFMA believes that such rulemaking should be completed before implementation of the Proposed Plan.

Importance of Valid Market Data. Accurate and timely market data will be critical to achieving the primary goal of the Proposed Plan of reducing excess market volatility. The primary securities information processors ("SIPs"), obviously, will play the key role in establishing pricing bands and providing information used by the SROs in establishing trading pauses. As such, the SIPs should have mechanisms to determine immediately when they have invalid or delayed market data and the ability to temporarily halt the dissemination of price bands and trading halts until they are able to resume the dissemination of accurate and timely market data.

Compliance Date and Evaluation of Pilot. Finally, SIFMA recommends that the Compliance Date for the Proposed Plan be no sooner than the second quarter of 2012. Given other programming demands on trading centers, any date sooner will be impracticable. In addition, although the Proposed Plan is well conceived and well intentioned, it is very complex – involving changing price bands, intermittent trading pauses and quotes that are visible but not

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[33] Exchange Act Release No. 64071 (March 11, 2011)(approving Nasdaq volatility guard and noting that later adoption of a market wide mechanism to moderate volatility might obviate the need for exchange specific measures).

always executable. The complexity of the proposal will be particularly acute from the perspective of retail investors. Thus, we believe that proper implementation of the Proposed Plan will require a significant amount of customer education and broker training.

Finally, we encourage the SROs and the Commission to seek comment when evaluating the effectiveness of the Proposed Plan at the end of the pilot period. In addition to the considerations noted above (*e.g.,* determination of the appropriate pricing bands and Limit State time frames), the SROs and the Commission should evaluate the effectiveness of the Proposed Plan in limiting market volatility associated with short term dislocation events, as well as its impact on market liquidity, clearly erroneous trades, costs and competition among market participants. Industry input in connection with the evaluation of these and numerous other factors will be important to assessing the overall utility of the Proposed Plan and to determining what, if any, modifications might be necessary to enhance its usefulness to the markets and investors.

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SIFMA appreciates the opportunity to comment on the Proposed Plan. We support the efforts of the Commission and the SROs to enhance safeguards against extraordinary market volatility caused by short term market dislocation events and believe that the Proposed Plan should help in this regard. As noted above, there are a variety of changes and guidance that will be necessary to effectively implement the Proposed Plan, and we look forward to working with the Commission and SROs in this regard. Similarly, given the interrelatedness of markets today, the Commission and SROs will need to work with the options markets and the CFTC to ensure that a consistent approach is used across markets if the Proposed Plan is to have its most beneficial effect.

Sincerely,

/s/ Ann L. Vlcek

Ann L. Vlcek
Managing Director and
Associate General Counsel
SIFMA

cc: Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
Kathleen L. Casey, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
Robert W. Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets

Exhibit G - Letter from Christian Krohn, Managing Director, Association for Financial Markets in Europe & Ann Vlcek, Managing Director, SIFMA, to Werner Bijkerk, Senior Policy Advisor, IOSCO (Feb. 1, 2011) (SIFMA's joint comments with AFME on the Committee's Report regarding Issues Raised by Dark Liquidity)

sifma

Invested in America

afme/

February 1, 2011

Mr. Werner Bijkerk
Senior Policy Advisor
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Re: Public Comment on Issues Raised by Dark Liquidity

Dear Mr. Bijkerk:

The Securities Industry and Financial Markets Association ("SIFMA")[1] and the Association for Financial Markets in Europe ("AFME")[2] welcome the opportunity to comment on the Technical Committee ("Committee") of the International Organization of Securities Commissions ("IOSCO") Consultation Report regarding Issues Raised by Dark Liquidity ("Report").[3] We appreciate the timeliness of the Committee's review of the various regulatory issues raised by dark liquidity, and we are pleased to comment on the five Topics set forth in the Report.

As a general matter, we believe that dark liquidity, including internalization practices of broker-dealers, provides genuine benefits to the markets and their participants (including intermediaries and professional and retail investors) without detracting from the overall vibrancy of displayed markets. For example, as the Committee is aware, dark liquidity often is used by market participants seeking to avoid adverse market impact when executing their trades. In addition, internalized executions by broker-dealers, in particular, provide investors – often retail investors – with speedy executions and, frequently, price improvement, mainly because broker-dealers retain control over the order execution process.

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[1] The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

[2] The Association for Financial Markets in Europe ("AFME") promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA). For more information, visit the AFME website, www.AFME.eu.

[3] Issues Raised by Dark Liquidity, Consultation Report, Technical Committee of the IOSCO (Oct. 2010) ("Report").

Moreover, we believe that the availability of dark liquidity has not impaired price discovery or execution quality in the U.S. or in Europe. To the contrary, displayed markets remain healthy. Indeed, the most recent studies we have seen regarding the U.S. markets demonstrate that the availability of dark liquidity venues has not, in fact, adversely impacted the displayed markets. For example, a very recent working paper on the impact of dark pools on U.S. market quality concludes that "a higher amount of dark pool activity is associated with lower quoted and effective spreads, lower price impacts, and lower short-term volatility. In other words, more dark pool activity is generally associated with higher market quality."[4]

The conclusions of this research are borne out by our experience with the U.S. and European markets. In the U.S., we note, for instance, the prevalence of very narrow spreads in national market stocks, indicating that effective and efficient price discovery is occurring in the public markets.[5] In addition, by protecting the top of book of U.S. trading centers, the Securities and Exchange Commission's ("SEC") Order Protection Rule (Regulation NMS Rule 611), which prohibits trade-throughs, is an effective supplement to the duty of best execution in policing execution quality.[6] Studies also indicate there have been improvements in depth of book display beyond the national best bid or offer ("NBBO").[7] These trends have occurred concurrent with the growth of alternative trading systems – which have offered significant opportunities for price improvement to their end users, including firms representing retail investors – as a percentage of all dark liquidity venues.

In light of the evidence to date, we believe that market participants should have the ability to utilize dark liquidity to facilitate their trading and that such dark liquidity would not adversely impact the U.S. and European markets. We acknowledge, however, that market structures and practices will continue to develop and may vary across jurisdictions. Therefore, we believe that it is critical that regulators, academics, market participants and other interested parties continue to perform empirical analyses of the effect of dark liquidity on transparent markets before making market structure changes that impede or limit the use of dark liquidity by broker-dealers and other market participants. Such analysis would allow lawmakers and

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[4] Sabrina Buti, Barbara Rindi and Ingrid M. Werner, Diving into Dark Pools, Fisher College of Business Working Paper (available at http://fisher.osu.edu/fin/faculty/werner/working_papers.htm).

[5] *See* O'Hara, Maureen and Mao Ye, *Is Market Fragmentation Harming Market Quality?* (Mar. 2009), 19, (available at http://ssm.com/abstract=1356839) ("In the post-Reg NMS world, effective spreads are extremely low, with average spreads in the 3-4 cent range. Turning to our specific hypothesis, the data show that effective spreads are lower in the fragmented sample on average by .29 cents with median spreads lower by .11 cents.").

[6] We understand that the Committee's mandate "does not cover issues relating to how best execution is to be met in relation to dark liquidity." Report at 5. However, we believe it is important to recognize that best execution is a key factor in determining the appropriate regulatory response to the use of dark pools.

[7] Angel, James J., Lawrence E. Harris, Chester S. Spatt, *The Economics of Trading in the 21st Century* (Feb. 23, 2010), 15 (available at http://www.knight.com/newsRoom/pdfs/EquityTradinginthe21stCentury.pdf). *See also* Yossi Brandes and Ian Domowitz, Investment Technology Group, Inc., Alternative Trading Systems in Europe: Trading Performance by European Venues Post-MiFID (May 2010) (available at http://www.itg.com/news_events/papers/ITG-Paper-AlternativeTrading-051910F.pdf) (concluding that European dark pools add value to their users by lowering transaction costs and reducing slippage).

regulators to accurately calculate the level of riskless principal and principal trading that occurs in the over-the-counter markets, and to respond appropriately to that knowledge. The need for a clearer understanding of dark liquidity and other over-the-counter trading is particularly acute in Europe where there is a general perception that circa 40 percent of European equities trading is the result of bilateral trades with clients and broker-dealers which could be moved directly onto the lit markets. In reality, the "OTC trades" percentage includes a vast number of technical trades that are required to be reported but form no part of price formation (*e.g.*, "give-up/in" trades between executing broker and prime broker) or which do not represent liquidity available to other market participants (*e.g.*, "risk facilitation" trades for clients which will subsequently be unwound in the market). In a January 24, 2011 paper entitled "Breaking Down the UK Equity Market: Executable Liquidity, Dark Trading, High Frequency and Swaps," the TABB Group "...estimates that while OTC-reported turnover accounts for 45% of the market, less than a quarter of it is executable. The balance, says [TABB], is in fact comprised of reprints of already-traded turnover with 72% of executable liquidity being traded on the lit order book of an exchange or multilateral trading facility (MTF)."

Specific Topics

1. Topic 1: Transparency to Market Participants and Issuers

a. Pre-Trade Transparency

In Principle 1, the Committee states that "[t]he price and volume of firm bids and offers should generally be transparent." We believe that Principle 1's focus on the need for pre-trade transparency fails to appropriately recognize the value that dark liquidity provides to the markets. Dark liquidity plays an important role in the investment trading process, in ensuring market efficiency, and in price formation.[8] As such, the use of dark liquidity, when properly regulated, will continue to be beneficial to investors of all types. Therefore, we urge the Committee to amend Principle 1 to specifically recognize the positive role that dark liquidity plays in the marketplace as well as the fact that different levels of pre-trade transparency may be appropriate for different market structures or order types.

The Principle's proposed general pre-trade transparency requirement reflects a concern that dark liquidity impairs price discovery and provides disincentives to publicly display

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[8] As the former Director of the SEC's Division of Trading and Markets, Erik Sirri, said,

> "... dark pools of liquidity have been around for a long, long time. The single largest dark pool in the world for many decades could be found on the trading floor of the New York Stock Exchange. The floor traders there manually represented a pool of undisplayed liquidity that could be accessed only by sending an order to the floor to probe buying and selling interest. ...Dark pools are solutions to a perennial trading dilemma for anyone that needs to trade in substantial size, particularly institutional investors. They provide a mechanism for such transactions to interact without displaying the full scale of their trading interest. Today, nearly every equity trading venue in the U.S. offers some sort of dark liquidity."

Speech by Erik Sirri at SIFMA 2008 Dark Pools Symposium, February 1, 2008.

quotations. These concerns appear to be based on the assumption that the use of non-displayed liquidity diverts order flow away from the public quoting markets, thereby adversely affecting the execution quality for those market participants that display their orders in the public markets. Based on history and practice in the U.S. and Europe, we believe these fears are unfounded or, at least, should be tested empirically.

First of all, there is no economic incentive for all (or most) liquidity to go dark. Trading professionals, particularly those with large orders that are likely to have a significant impact on the market (*e.g.,* orders for money managers that oversee collective pools of assets contributed by individuals), always have a dual focus when seeking best execution of their orders: displaying a quote to achieve a more certain execution (with the risk of moving the market adversely) versus not displaying a quote in an attempt to reduce market impact and potentially obtain price and/or size improvement. This natural "give and take" between certainty of execution (and eliminating "opportunity cost risk") and managing market impact (with attempted price/size improvement) works to maintain equilibrium between non-displayed and displayed liquidity.

Indeed, such equilibrium generally has been maintained over the years, even as non-displayed liquidity has evolved from a manual process to more automated solutions. For example, since the early years of the New York Stock Exchange and other stock exchanges, there have been floor brokers who worked large orders discreetly in order to obtain the best possible price for investors. In the over-the-counter markets, traders held their trading interest on their desks and used the telephone to call trusted partners to inquire about possible matches. As markets have evolved, new ways of managing this trading process and the risks associated with displaying large trading interest have developed. The growth in the number of alternative trading systems, MTFs, and Broker Crossing Networks (BCNs), for example, can be viewed as a natural and necessary electronic evolution of an age-old process, rather than a new trading concept.

In addition, we note that dark orders and related trading activity are part of the price discovery process. Market participants that use dark orders constantly monitor and respond to displayed bids and offers as well as to last sale and volume traded information (which originates from both displayed and undisplayed order types and markets). Market participants using dark order types display orders when market conditions compel them to shift from passive to more aggressive interaction with the marketplace. For example, when the market price of a security changes or transaction volume is reported to the market (again, whether executed at a displayed market or dark pool), such activity can cause trading behavior to change from passive (*i.e.*, use of undisplayed or partially displayed orders) to active, where a trader will "take" or display liquidity.

In our view, markets and trading technologies naturally evolved considerably over time, becoming more sophisticated and complex; however, the markets have not been adversely impacted by the availability of dark liquidity. Therefore, we urge the Committee to continue to recognize the benefits of dark liquidity to investors. Nevertheless, we support periodic reviews of new trading developments to ascertain their effect on market efficiency and the price

discovery function and to determine whether new or different regulation is needed. As such, we support Principle 1's statement that regulators should consider the impact of new types of dark liquidity on price discovery, fragmentation, fairness and overall market quality.[9]

b. Post-Trade Transparency

With regard to Principle 2, we support the goal of providing post-trade transparency for trades executed in dark pools or as a result of dark orders entered into transparent markets. We also believe, however, that any such post-trade transparency requirements must be balanced against the interests of investors using dark liquidity to minimize market impact when effecting their transactions. In particular – and noting that current trade reporting requirements vary between jurisdictions (for example, Dark MTF trades are reported in real-time with a venue identifier in Europe), we are opposed to the extension of real-time trade reporting of the identity of dark pool operators, including ATSs and BCNs, on the basis that this would impose unnecessary risks to market participants seeking the best manner in which to execute their orders. Many large "parent" orders are, in fact, executed as a series of smaller "child" orders in today's markets. Thus, the extension of real-time trade reporting of dark pool operator identities will lead to information leakage that ultimately will harm the ability of users of dark pools to execute orders without market impact.[10]

Real-time reporting of the identity of a dark pool operator in trade reports raises more concerns than does identifying executing exchanges on trade reports. Most dark pool operators have a relatively small percentage of overall market share. Many dark pool operators also generally have fairly narrow business models, many with specific matching criteria and specific types of users, as opposed to the more broad business models used by exchanges. The combination of these factors means that sophisticated traders have a greater ability to ascertain information related to the activity in the dark pool – specifically, the kinds of working orders likely to be active in the dark pool at any given time – than they would for an exchange. Therefore, real-time identification of dark pool operators in trade reports would significantly enhance the ability of sophisticated traders to ascertain large orders within such systems, particularly orders in smaller dark pool operators. This information could then be used to trade in a manner to the ultimate detriment of the users of a dark pool. By contrast, the identification

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[9] The Committee notes that "[r]egulators should consider whether it is appropriate to treat actionable indication of interest ("IOIs") as firm quotes." We note that the SEC has previously differentiated IOIs and orders by describing IOIs as interest to buy or sell a security where the price, side or number of shares is not always specified, unless the price or size is implied. In other words, an IOI is trading interest that cannot be executed without further interaction between the market participants. We support the continued reliance upon this previously articulated definition of an IOI. However, we urge regulators to clarify and then appropriately enforce the application of this definition to new types of trading interests as they appear. Similarly, we support the European Commission proposal in its MiFID Review Consultation Paper to treat actionable IOIs as orders.

[10] For example, order anticipation strategies employed by proprietary trading firms attempt to ascertain the existence of a large buyer or seller in the market and to trade in the direction of that trading interest. Such strategies may include the use of sophisticated pattern recognition software to ascertain the existence of a large buyer or seller from publicly available information, or the use of orders to "ping" market centers to locate and trade in front of large buyers or sellers.

of exchanges in real-time trade reports is less problematic because the trades are not identified by individual broker-dealer, but instead are attributed to the exchange more generally. It is important to note that, in the U.S. and in Europe (and perhaps in other jurisdictions), the use of non-displaying trading systems is not limited to institutions or broker-dealers representing institutional orders. Rather, all types of order-sending firms within the broker-dealer community, including those handling retail orders, access such trading systems. As a result, the negative impact of providing real-time identifying information regarding dark pool operators will be felt across a broad spectrum of market participants, including retail investors.

Moreover, real-time disclosure of the identity of dark pool operators on trade reports is unnecessary because there are alternatives that would better achieve the transparency goals without inadvertently generating negative consequences for investors. Specifically, we believe that the timing of dark pool trade data disclosure should reflect the liquidity of the securities concerned. For example, we recommend end-of-week reporting of ATS trade data on a symbol-by-symbol basis for each ATS. If end-of-week reporting is deemed insufficient, end-of-day public reporting of the identity of dark pool operators executing trades in relatively liquid National Market System stocks and most European stocks should achieve the regulators' goals while sufficiently protecting dark pool users from adverse market impacts that would result from real-time disclosure of the identity of the dark pool operator in trade reports. For less liquid stocks (*e.g.*, Nasdaq Capital Market stocks), we believe that end-of-week public trade reporting would be necessary because end-of-day trade reporting in such names likely would result in the same information leakage concerns raised by real-time reporting of a dark pool operator's identity in trade reports.

We appreciate that regulators may need increased transparency of the identity of dark pool operators effecting trades to effectively surveil the markets. If the regulators believe that real-time reporting of the identity of dark pool operators executing trades is necessary for regulatory purposes, we would support disclosure of such information to regulators. Our primary concern with any proposal to identify dark pool operators on a real-time basis centers on the negative consequences that likely would attend such reporting to the public. We have no such concerns with respect to the availability of such reports to regulators for oversight purposes.

2. Topic 2: Priority of Transparent Orders

We agree with the general goal of Principle 3 – that is, ensuring that there are adequate transparent orders in the marketplace. However, we believe that such a goal must be appropriately balanced with the recognition of the value of dark liquidity. As such, we would oppose substantial limitations on the use of, or disincentives to use, dark liquidity for the reasons discussed above. While we thus accept that transparent orders should have priority over dark orders on the same order book, we believe that a cross-venue requirement for transparent orders to take priority over dark orders would curtail best execution and disadvantage investors. Instead, we believe the U.S. approach of relying on, among other things, the duty of best execution, the Order Protection Rule, and consolidated market data to incent transparent orders is the better practice. We, therefore, urge the Committee to incorporate into Principle 3 the need to

carefully evaluate the effect of any disincentives to use dark liquidity on the markets and their participants in light of the benefits of dark liquidity (as discussed above).

3. Topic 3: Reporting to Regulators

We support the objective articulated in Principle 4 that regulators should have access to sufficient information about trades executed in dark pools or via dark orders to effectively surveil the markets. As noted above, we would limit the public dissemination of pre-trade information and certain post-trade information related to such dark trading given the likely negative consequences of such information sharing. Reporting such information to the regulators, however, would not raise those same concerns. Therefore, we would support such trade reporting as may be necessary and appropriate for oversight purposes.

4. Topic 4: Information Available to Market Participants about Dark Pools and Dark Orders

We fully support the requirement set forth in Principle 5 for dark pools and transparent markets that offer dark orders to provide participants with sufficient information to understand the manner in which their orders are handled and executed. The benefits of dark trading rely on keeping trading interest confidential; however, this does not mean that participants should be kept in the dark as to the manner of trading itself. Therefore, as the Committee suggests, we would urge dark pools and transparent markets with dark orders to provide participants with detailed information on how trading occurs, to include explanations of priority, the order interaction between dark and transparent liquidity, any use of indications of interest, and who has access to trading information.

5. Topic 5: Regulation of the Development of Dark Pools and Dark Orders

As we note above, we believe that it is critical for regulators to keep abreast of new developments in the markets, and to respond to such developments as warranted. This objective applies as well to dark pools and dark orders. Therefore, we support Principle 6 as articulated by the Committee, and agree that regulators should monitor the development of dark pools and dark orders to seek to ensure that such developments do not adversely affect the efficiency of the price formation process on displayed markets, and take appropriate action as needed.

* * * * *

We appreciate this opportunity to comment on the issues raised in the Report. If you have any comments or questions, please do not hesitate to contact the undersigned at christian.krohn@afme.eu or avlcek@sifma.org.

Sincerely,

/s/ Christian Krohn

Christian Krohn
Managing Director
AFME

/s/ Ann Vlcek

Ann Vlcek
Managing Director
SIFMA

cc: Mr. Carlo Comporti, Acting Secretary General
European Securities and Markets Authority

Mr. Emil Paulis, Director Financial Services Policy and Financial Markets
European Commission

Mary L. Schapiro, Chairman
U.S. Securities and Exchange Commission

Luis A. Aguilar, Commissioner
U.S. Securities and Exchange Commission

Kathleen L. Casey, Commissioner
U.S. Securities and Exchange Commission

Troy A. Paredes, Commissioner
U.S. Securities and Exchange Commission

Elisse B. Walter, Commissioner
U.S. Securities and Exchange Commission

Exhibit H - Letter from James T. McHale, Managing Director and Associate General Counsel, SIFMA, to David Shillman, Associate Director, Division of Trading and Markets, SEC (Jan. 12, 2011) (SIMFA "drop copy" counterproposal)

sifma

Invested in America

January 12, 2011

Mr. David Shillman
Associate Director
Division of Trading and Markets
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Consolidated Audit Trail; Release No. 34-62174; File No. S7-11-10

Dear David:

SIFMA would like to thank you and your colleagues for meeting with SIFMA's Consolidated Audit Trail ("CAT") Working Group last fall to discuss this important regulatory initiative. As discussed at the meeting and in our comment letter, SIFMA fully supports the SEC's objective of providing timely access to a robust, cross-market audit trail for NMS securities and ultimately other securities.

Following up on our discussion, SIFMA's CAT Working Group has prepared the attached "Drop Copy" proposal, which sets out order and execution data that feasibly could be provided to a CAT processor in near real-time and could be implemented relatively quickly. We hope that you find this proposal to be helpful and look forward to further discussions with you and your colleagues.

Please feel free to contact me directly with any questions at (202) 962-7386 or jmchale@sifma.org.

Sincerely,

/s James T. McHale

James T. McHale
Managing Director and Associate General Counsel

Enclosure

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SIFMA "Drop Copy" Proposal

Introduction

- SIFMA continues to question the need for real-time reporting of the entire set of data elements in the CAT proposal, and believes that reporting on a T+1 (or in some cases later) basis should satisfy the SEC's stated regulatory objectives more efficiently.

- However, if the SEC determines to require reporting of certain data elements in real-time or near real-time, we believe such data should be limited to reporting of **"key business events,"** as defined below.

- Definition of "real-time": We note that the implementation options and complexity are significantly different if the reporting regime is within "minutes" rather than "seconds." If real-time reporting is required in seconds, then significant re-engineering is required within broker-dealer order management systems and trading systems to support such a requirement (e.g., passing additional information between systems, performance tuning to compensate for additional processing of payload). Instead, if the definition of real-time allows for reporting within minutes (e.g., 10-15 minutes) of the events, it would be substantially less intrusive on order management systems and may allow for greater flexibility in designing reporting systems architecture and more standardized content for events such as order modifications, as described below. Also, as with prior implementations of new trade reporting regimes in the U.S. (e.g., ACT, TRACE), having more liberal reporting timeframes for an appropriate initial period (e.g., 12 months or more) to provide a sufficient period to optimize processes would be very helpful.

Assumptions

- Our proposal does not include a "unique customer ID" or a "large trader ID." While a unique customer or large trader ID would not be incompatible with our proposal, we focus below on a solution that is achievable in the relative near-term. Development of a customer or large trader ID is outside the scope of this proposal because of the complexity of the technology development work involved and the difficult governance issues noted in SIFMA's comment letter. We also note the Office of Financial Research's separate proposal to establish a universal, industry-wide Legal Entity Identifier, which the OFR suggests could be used by securities regulators in the context of a consolidated audit trail.

- We also would not include a flag for algorithmic orders, due to the current lack of clarity regarding the definition of what "algorithmic" orders are, and the fact that the FIX standard does not currently have existing fields defined and implemented to flag these types of orders.

- Also, our proposal does not contemplate an order identifier that is unique across all firms or that would be passed from firm to firm.

- In addition, under the SIFMA proposal, trade executions would be reported to the CAT only once by the exchange/venue/broker that executes and not by any other firms in the chain. Broker-dealers would only report "internalized" executions (i.e., agency cross, principal, and riskless principal transactions).

- Finally, we would propose that any follow-up requests for additional information about these transactions would not include any information already provided to the CAT via drop copy.

"Key business events" are defined broadly as: Order Receipt and Origination; Order Transmittal; Order Execution; Order Modification; and Order Cancelation. For each of the key business events, firms or the exchanges/TRF would report defined data elements as follows:

A. Order Receipt and Origination[1]
FIX message: New Order Single (Type D)
Data Elements:
(1) An order identifier that uniquely identifies the order for the date it was received or originated;
(2) the date and time the order is received or originated by a reporting member;
(3) the identification symbol of the security to which the order applies;
(4) the market participant symbol assigned by FINRA to the reporting member (SendingCompId);[2]
(5) the number of shares to which the order applies;[3]
(6) the designation of the order as a buy or sell order;
(7) the designation of the order as a short sale or a short sale exempt order;[4]
(8) the designation of the order as a market order, limit order, stop order or stop limit order;
(9) any limit or stop price prescribed in the order;
(10) the date on which the order expires, and, if the time in force is less than one day, the time when the order expires;
(11) the time limit during which the order is in force; and
(12) special handling requests (e.g., "all or none" orders).

B. Order Transmittal
FIX message: New Order Single (Type D)
Data Elements:
(1) an order identifier that uniquely identifies the transmitted order;[5]

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[1] Note that orders can be "received" from (i) clients of the broker-dealer and include orders generated by employees of the broker-dealer for advised accounts; and (ii) orders from affiliates of the broker-dealer. Order Origination applies to orders that are initiated by a broker-dealer for its own account, and may also include orders for the proprietary accounts of affiliates. Depending upon whether a firm is receiving an order or originating a proprietary order, the information in field 4 will vary.

[2] MPID standards need to be defined for listed options and other product classes which do not use FINRA MPIDs currently to identify market participants, and also for firms that are not FINRA or NASDAQ members as well as for exchanges.

[3] The number of contracts for listed options.

[4] Not applicable for listed options; applicable only for composite orders on stock leg.

[5] Routed order id (unique identifier on the route message) or the Child order identifier. Note that this identifier would not be the same unique order identifier of the Parent order reported. To the extent that order identifier linkage is required across different order handling events, we would propose that this order identifier linkage information be reported separately to CAT on a non-real time basis. To the extent that reporting timeframes are longer, the ability to also provide linkage information would be more feasible.

(2) the date and timestamp the order is released to a market center;
(3) the market participant symbol assigned by FINRA to the reporting member (SendingCompId);[6]
(4) the market participant symbol assigned by FINRA of the receiving firm (TargetCompId);[7]
(5) the identification symbol of the security to which the order applies;
(6) the number of shares to which the order applies;[8]
(7) the designation of the order as a buy or sell order;
(8) the designation of the order as a short sale or a short sale exempt order;[9]
(9) the designation of the order as a market order, limit order, stop order or stop limit order;
(10) any limit or stop price prescribed in the order;
(11) the date on which the order expires, and, if the time in force is less than one day, the time when the order expires;
(12) the time limit during which the order is in force; and
(13) special handling requests (e.g., "all or none" orders).

C. Order Execution

FIX message: Execution message (Type 8)

Data Elements:

(1) an order identifier that uniquely identifies the order receiving the executions;
(2) the market participant symbol assigned by FINRA to the reporting member (SendingCompId);[10]
(3) an unique identifier of execution message;
(4) the date and timestamp of the execution;
(5) the identification symbol of the security to which the order applies;
(6) the designation of the order as a buy or sell order;
(7) the designation of the order as a short sale or a short sale exempt order;[11]
(8) the execution capacity (only agency or principal);
(9) the market of execution for last fill;
(10) the execution price; the number of shares bought or sold;[12]
(11) the contraparty;
(12) the order status; and
(13) the trade condition.

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[6] *See* note 2, *supra*.

[7] *See* note 2, *supra*.

[8] *See* note 3, *supra*.

[9] *See* note 4, *supra*.

[10] *See* note 2, *supra*.

[11] *See* note 4, *supra*.

[12] *See* note 3, *supra*.

D. Order Modification[13]

FIX message: Order Cancel Replace Request (Type G)

Data Elements:

(1) an order identifier that uniquely identifies the order modification;
(2) an order identifier of the previous non rejected order;
(3) the market participant symbol assigned by FINRA to the reporting member (SendingCompId);[14]
(4) the market participant symbol assigned by FINRA of the receiving firm (TargetCompId);[15]
(5) the date and timestamp the order is modified;
(6) the identification symbol of the security to which the order applies;
(7) the number of shares to which the order applies;[16]
(8) the designation of the order as a buy or sell order;
(9) the designation of the order as a short sale or a short sale exempt order;[17]
(10) the designation of the order as a market order, limit order, stop order or stop limit order;
(11) any limit or stop price prescribed in the order;
(12) the date on which the order expires, and, if the time in force is less than one day, the time when the order expires;
(13) the time limit during which the order is in force; and
(14)special handling requests (e.g., "all or none" orders).

E. Order Cancellation[18]

FIX message: Order Cancel Request (Type F)

Data Elements:

(1) an order identifier that uniquely identifies the cancel request;
(2) an order identifier of the previous non rejected order;
(3) the market participant symbol assigned by FINRA to the reporting member (SendingCompId);[19]
(4) the market participant symbol assigned by FINRA of the receiving firm (TargetCompId);[20]

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[13] Note that different order handling systems may only capture or send the individual data elements that are being changed on order modifications (rather than the entire modified order); therefore, CAT needs to accommodate that different parties may report these events differently. Also, different order handling systems and exchanges may handle order modifications as order cancellations and new orders transmittals; therefore, the CAT needs to accommodate that different parties may represent these business events differently in their CAT submissions.

[14] *See* note 2, *supra*.

[15] *See* note 2, *supra*.

[16] *See* note 3, *supra*.

[17] *See* note 4, *supra*.

[18] Since different order management systems handle order cancellation events differently, and not capture all attributes for order cancelations, it may be sufficient to merely submit the order id of the order being cancelled and not all of the additional data elements.

[19] *See* note 2, *supra*.

[20] *See* note 2, *supra*.

(5) the date and timestamp the order was cancelled;
(6) the identification symbol of the security to which the order applies;
(7) the number of shares cancelled;[21]
(8) the designation of the order as a buy or sell order; and
(9) the designation of the order as a short sale or a short sale exempt order.[22]

[21] *See* note 3, *supra*.

[22] *See* note 4, *supra*.