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May 2, 2016

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

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-03-16: Notice of Proposed Commission Interpretation Regarding Automated Quotations under Regulation NMS

Dear Mr. Fields:

The Securities Industry and Financial Markets Association ("SIFMA")[1] submits this letter to comment on the Securities and Exchange Commission's ("Commission") proposed interpretation of the term "automated quotation" under Rule 600(b)(3) of Regulation NMS. SIFMA believes that the proposed interpretation would raise significant market structure questions and could increase market complexity. We expect the Commission will be faced with additional questions if the interpretation is adopted. For practices adopted by exchanges in response to the interpretation, the Commission should address questions through the consideration and approval of proposed rule changes by the exchanges with the opportunity for public comment. For cases of general applicability, the Commission should provide written guidance or FAQs.

We discuss some of those issues below. In addition, we request that the Commission clarify the impact of the proposed interpretation on certain aspects of Rule 611 of Regulation NMS.

Automated Quotations under Regulation NMS

The Commission has proposed to interpret the word "immediate" when determining whether a trading center maintains an "automated quotation" for purposes of Rule 611 of Regulation NMS to include a de minimis response time delay at a trading center, whether the

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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 http://www.sifma.org.

delay is intentional or not. In this regard, the Commission indicates that a delay of less than one millisecond would be considered de minimis.

Rule 611 of Regulation NMS, known as the "Order Protection Rule," prohibits trading centers from engaging in "trade-throughs" of "protected quotations." Under Rule 600 of Regulation NMS, a quotation is "protected" only if it is an "automated quotation." Regulation NMS defines an "automated quotation" to be a quotation displayed by a trading center that

(i) Permits an incoming order to be marked as *immediate*-or-cancel;
(ii) *Immediately* and automatically executes an order marked as immediate-or-cancel against the displayed quotation up to its full size;
(iii) *Immediately* and automatically cancels any unexecuted portion of an order marked as immediate-or-cancel without routing the order elsewhere;
(iv) *Immediately* and automatically transmits a response to the sender of an order marked as immediate-or-cancel indicating the action taken with respect to such order; and
(v) *Immediately* and automatically displays information that updates the displayed quotation to reflect any change to its material terms (emphasis added).

The key term in the definition is the word "immediate." Although the Commission has not yet provided a specific definition in Regulation NMS for the term "immediate," the adopting release for Regulation NMS contains explicit guidance that sets forth the Commission's thinking and intent at the time. It clearly states that:

> The definition of automated quotation as adopted does not set forth a specific time standard for responding to an incoming order. The Commission agrees with commenters that the standard should be "immediate" – i.e., a trading center's systems should provide the fastest response possible without any programmed delay.[2]

Additionally, the Commission stated in the adopting release that the term "'immediate' precludes any specific coding of automated systems or other type of intentional device that would delay the action taken with respect to a quotation."[3]

Application of the Proposed Interpretation

In light of its previous statements, the Commission should apply the proposed interpretation carefully and judiciously. If it adopts the proposed interpretation, the Commission

2 Regulation NMS, Exchange Act Release No. 51808 (June 9, 2005), 70 Fed. Reg. 37496, 37519 (June 29, 2005) ("Adopting Release").

3 *Id.* at 37534.

should be clear about the application of the interpretation to intentional delays established by trading centers.

First, the Commission should state that any intentional delay should apply only to the transmission of relevant information between the trading center and the broker-dealer. More specifically, the interpretation should apply only to the transmission of transactional information (e.g., orders, trades, quotes, indications, and confirmation reports) between the trading center and the broker-dealer.

Second, any intentional delay should be predictable and universally applied to all market participants in a non-discriminatory manner. For instance, the following list is illustrative of the type of activity and access that should not be allowed under the proposed interpretation:

- A trading center allowing particular types of market participants (e.g. market makers) or customers (e.g. institutional) to avoid the delay.
- A trading center subjecting principal orders to a delay but allowing agency orders to avoid it.
- A trading center establishing a delay and then offering specific order types that avoid the delay.
- A trading center establishing fee schedules that permit firms to pay an extra fee to avoid the delay.

Impact of Proposed Interpretation on other Trade-Through Exceptions

In two cases under Rule 611 of Regulation NMS, the Commission has indicated that one second is an appropriate time frame to use in connection with exceptions to the order protection rule. The first relates to Rule 611(b)(1), which sets forth the so-called “self-help” exception to the order protection rule. That exception states that a trade-through does not violate Rule 611 if

> [t]he transaction that constituted the trade-through was effected when the trading center displaying the protected quotation that was traded through was experiencing a failure, material delay, or malfunction of its systems or equipment.

In adopting Regulation NMS, the Commission stated that the use of this exception is appropriate in response to a trading center that repeatedly fails to respond to an immediate-or-cancel order within one second.

The second relates to Rule 611(b)(8), which sets forth a exception from trade-throughs for so-called “flickering quotations.” The exception states that a trade-through does not violate Rule 611 if

> [t]he trading center displaying the protected quotation that was traded through had displayed, *within one second prior to execution* of the transaction that constituted the trade-through, a best bid or best offer, as applicable, for the NMS stock with a price that was equal or inferior to the price of the trade-through transaction." (emphasis added).

If the Commission adopts the proposed interpretation, it should explicitly state how the interpretation would relate to those two exceptions. SIFMA's reading of the proposal is that it would not change the one second thresholds currently in place under the flickering quote and self-help exceptions. In particular, we urge the Commission to be clear that it is not setting one millisecond as the threshold for declaring self-help. Trading centers routinely experience unintentional latency delays of more than one millisecond for reasonable situations, such as significant and periodic increases in message traffic. Accordingly, firms should not be obligated to declare self-help for every delay of more than one millisecond.

Additional Questions for Review and Consideration

SIFMA believes that the proposed interpretation raises additional questions that the Commission should consider and specifically address. For instance:

- How and by whom will delays be measured? For example, will the period be measured in terms of the time it takes for information to be transmitted within a trading center's systems? Or will it be measured in terms of the time it takes information to travel from a trading center's gateway to its matching engine or from the matching engine back to the gateway?

- Who is responsible for tracking and reporting the delay?

- What are the consequences of violating the one millisecond threshold? For example, if a trading center exceeds the threshold, will its displayed quotations no longer be protected? Will a trading center lose protected status after exceeding the threshold once, or only after exceeding the threshold on a regular basis?

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SIFMA appreciates the Commission's consideration of the issues raised in this letter. If you have any questions or require further information, please contact me at (202) 962-7383 (tlazo@sifma.org), or Timothy Cummings at (212) 313-1239 (tcummings@sifma.org).

Sincerely,

Theodore R. Lazo
Managing Director and
Associate General Counsel

cc: The Honorable Mary Jo White, Chair
The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner

Stephen Luparello, Director, Division of Trading and Markets
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