

February 14, 2000

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Washington, DC 20006-1500

Mary L. Schapiro
President
National Association of Securities Dealers, Regulation
1735 K Street, NW
Washington, DC 20006-1500

Dear Ms. Schapiro and Mr. Ketchum:

As you know, a Securities Industry Association ("SIA") *Ad Hoc* Committee has worked diligently over the last several years with staff from the National Association of Securities Dealers, Regulation ("NASDR") to provide industry input during the development and implementation of the NASD Order Audit Trail System ("OATS"). As you may also know, there is an issue of critical importance to the industry in connection with implementation of Phase Three, scheduled for July 2000, that we have been urging NASDR staff to resolve quickly. Specifically, with implementation of Phase Three, the time that an order is received, and therefore the time that must be captured and reported, will be the time the order is received from the customer. Currently, an order is reportable when all of the specific details are understood and the order is entered into an electronic system for execution. This is the time that is captured and reported to OATS today.

The *Ad Hoc* Committee has consistently questioned the utility of reporting the time the order is received from the customer. For purposes of the audit trail, we believe the more meaningful time is the time the order is entered into an electronic system for execution. Having reliable and accurate records *to the second* of the time an order is entered into an electronic

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system will enable NASDR to determine compliance with certain rules, such as the firm quote and trade reporting rules, but is not critical to determining compliance with **all** NASDR rules. We note that order receipt time is, in fact, *recorded* and available to examination staff on request. However, the cost associated with *reporting* this time using a synchronized time clock is out of proportion to the regulatory benefit that will accrue.

While most firms use some type of electronic order management and execution system, orders transmitted through non-electronic means, *e.g.*, over the telephone, present a difficult and costly problem for the industry. In order to capture the time such orders are received for purposes of OATS reporting, firms are required to replace all mechanical time stamp machines in branch offices and other remote locations that record a level of granularity in minutes rather than seconds and replace them with OATS-compliant equipment. This is a huge undertaking for most firms, particularly small and medium-size firms that still employ paper-based ticketing systems. Nevertheless, firms have begun to purchase new systems, make extensive changes to existing front-end systems, or change entirely established business practices to prepare for their reporting requirements under Phase Three.

The *Ad Hoc* Committee believes that capturing and reporting the time an order is received from a customer, rather than the time an order is entered into an electronic system for execution, will yield information that is much less useful from a regulatory perspective. The *Ad Hoc* Committee has therefore urged NASDR staff to consider changing the OATS rules to define “order receipt time” as the time an order is entered into an electronic order entry system for execution.¹ This would resolve most of the issues, which the *Ad Hoc* Committee has struggled with over the last several years, that arise when you attempt to integrate manual orders into an automated audit trail.

We have had several productive meetings with NASDR staff over the last several months and we believe there is general agreement about which time better serves the regulatory objectives. However, because of the need for a rule change, the issue remains unresolved. In the absence of a rule change, firms are making costly changes to meet the requirements of Phase Three. These are resources that could be devoted to other upcoming initiatives involving systems changes, such as decimalization and T+1 settlement. If NASDR subsequently changes the rule, as we believe is the likely and logical thing to do, the expenditures will have been unnecessary. We therefore urge you to resolve this issue expeditiously. In the meantime, we

¹ Related changes to the books and records rules would also be required to relieve firms of the obligation to record a time synchronized to seconds for all market events, and to apply this requirement only to the OATS rules.

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request that you consider delaying the effective date of Phase Three. At a minimum, with an effective date of July 2000, we ask that you include manual orders at the time they reach a Trading Desk and grant firms relief from the obligation to report the time the manual order is received from the customer until a later date.

If you have any questions, or would like to discuss this further with the *Ad Hoc* Committee, please contact me or Judith Poppalardo, Staff Advisor to the Committee, at 202-296-9410.

Sincerely,

Christopher R. Franke
Chairman
Self-Regulation and Supervisory
Practices Committee

CC: Annette L. Nazareth, Director, Division of Market Regulation, SEC
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