



Securities Industry Association

120 Broadway, New York, NY 10271-0080, (212) 608-1500, Fax (212) 608-1604
1401 Eye Street, NW, Washington, D.C. 20005-2225, (202) 296-9410, Fax (202) 296-9775
info@sia.com, <http://www.sia.com>

October 24, 2000

Ms. Margaret McFarland,
Deputy Secretary
U.S. Securities & Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: SR-NASD-00-23; Amendment No. 1 to Order Audit Trail System Rules

Dear Ms. McFarland,

The Securities Industry Association ("SIA")¹ is pleased to offer its views on the amended NASDR rule filing relating to the Order Audit Trail System ("OATS"). As you know, an SIA Ad Hoc Committee has worked diligently over the last several years with staff from the Securities and Exchange Commission ("SEC") and National Association of Securities Dealers, Regulation ("NASDR"), to provide industry input during the development and implementation of OATS.

The proposed amendment would create separate receipt times for manually entered orders above and below 10,000 shares; exclude from the reporting requirements firms that route all orders on a non-discretionary basis to another member; require ECN's and market makers to capture and report order identifiers from sending firms; and, exempt small non-market making order entry firms from the reporting requirements.

SIA notes the following concerns in connection with the amended filing:

Rule 6954(b); Order Origination and Receipt

SIA objects to this provision of the amended filing which mandates different receipt times for manual orders depending on whether the order is above or below 10,000 shares. Under the proposed rules, OATS reports for orders less than 10,000 shares will require the time of receipt at the trading desk while reports for orders greater than 10,000 shares will require the time the order is received by the member. For electronic orders, however, the proposed rule would codify the staff's current position that the order origination and receipt time is the time the order is captured by a member's electronic order-routing or execution system.² NASDR noted in the

¹ The Securities Industry Association brings together the shared interests of more than 740 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans. The industry generates more than \$300 billion of revenues yearly in the U.S. economy and employs more than 600,000 individuals. (More information about the SIA is available on its home page: <http://www.sia.com>.)

² If an order is received manually and then immediately captured in an electronic system, the time the order is captured by such system has been interpreted to be the time of receipt. See OATS Reporting Technical Specifications, Section 4.1.3.

proposed filing that this definition of time of receipt is a close substitute for the time an order is received by the trading desk because the routing through the electronic system to the trading desk is nearly instantaneous.³

SIA believes requiring separate receipt times for manually handled orders will be particularly burdensome in that it will require salespersons in the branches and trading floors of a firm to determine, on an order-by-order basis, the appropriate receipt time for OATS purposes. We expect that the number of honest mistakes made attempting to comply with a bifurcated rule will result in more erroneous reports and unnecessary delays in order entry and routing. As a result, we can expect delays in limit order display (if applicable) and potential missed markets for investors, thereby effecting the overall execution quality of customers' orders.

Moreover, a two-track plan for manual orders was not included in the most recent draft proposal that was submitted to the Commission in April, but never noticed for comment. The Committee has worked with the NASDR and the Commission throughout the OATS process and understood that there was complete agreement on the need for consistency in this area to avoid operational and compliance problems. In both the April filing as well as the current proposal, NASDR noted that the time of order receipt from a customer "...is of little value. . ." to NASDR's automated surveillance for identifying potential violations of the limit order protection and display rules as well as best execution rules. Moreover, NASDR expressly stated that the more useful time for purposes of surveillance of potential violations of these rules is the time that an order is received at the trading desk or department.⁴ While NASDR notes in the current proposal that block size orders may be treated differently under the SEC's Order Handling Rules, the filing lacks an explanation of why this bifurcated approach to order entry time of manual orders is necessary or appropriate and makes no attempt to analyze the burden to firms in complying with this new requirement.

In addition, NASDR noted in its filing that existing requirements of SEC Rule 17a-3(a)(6) and anticipated amendments require member firms to record in their books and records the time an order is received from a customer. Thus, member firms could make such information available on a case-by-case basis upon request. The Committee believes that current rules are sufficient in the event such data is necessary for NASDR or SEC investigations and examinations.

SIA strongly opposes a two-track rule for manual orders and urges the NASD and SEC to restore the previously agreed-upon definition of receipt time as the time an order hits a trading desk.

Rule 6954c(3) and c(4): Order Transmittal

For many kinds of orders – particularly blocks, thinly traded issues and those with special instructions - manual handling is still the most efficient method of order handling. The NASD proposal imposes a new requirement on ECN's and other members that receive manual orders for execution or further rerouting to report the order identifier assigned to the order by the member that transmits the order. Two critical questions of implementation are left unaddressed by the rule proposal: (1) How will an originating firm generate an ID number for manually received orders that are routed to a market maker or ECN upon receipt? (2) How will an originating firm reliably and efficiently transmit ID numbers for manually transmitted orders? One firm that provides execution and clearing services reports that it receives 500 to 1000 of these orders each day.

³ See 65 FR 59038.

⁴ Note 3 at 59040

Imagine the logistics involved in generating up to a twenty-digit number for each order and relaying that number to a receiving firm. Now consider repeating that process 500 to 1000 times a day amidst all the other responsibilities of order handling and execution and you can guess at the devastating impact this will have on customers' ability to get their orders displayed (if applicable) and timely executed at the best available prices.

SIA believes that there are serious operational and logistical issues associated with compliance with this new requirement. First, manually handled orders are not presently entered into the receiving firm's system. Therefore, no systemic order identifier is generated. It would be unproductive and inefficient to assign a trader on an agency desk the responsibility of assigning each order a unique order identifier for OATS purposes. This will not only detract from the trader's ability to provide best execution to the order, but it will also result in an overall reduction in the number of orders that can be processed. Furthermore, the risk of confusion, duplication and bad data will be exacerbated with the addition of separate control points within a firm that each have responsibility for generating ID numbers.

Moreover, given the difficulty of generating and orally relaying up to a twenty digit number for each transmitted order, order entry firms may be forced to make order-routing decisions based on the ability of a market maker or ECN to offer an efficient means of transmitting order ID information.⁵ Certainly, every transmitting firm and receiving firm that could conceivably partner up on an order will need to have worked out a protocol for orders that pass between them. This raises competitive issues that may not have been thought through.

For example, an ECN or market maker that currently has an interface with the trader's desk for an unrelated purpose – i.e., market information, order routing for limit and special kinds of orders – would have an unfair advantage over another ECN or market maker. Having to choose between a market center which can assist in OATS reporting and a market center that enjoys no such favored status with the firm but competes favorably on price will create a compliance dilemma for many firms.

Correspondent Firm Exclusion from OATS Reporting

Finally, providing an exemption to correspondent clearing firm customers (those who send all their order flow), but not to other kinds of order entry firms, is inequitable and is likely to hasten the decision by some firms to entrust all of their order flow with one executing party. For instance, a correspondent firm that routes 99% of its order flow to its clearing firm, but routes 1% of its order flow directly to an ECN or other market center, could not avail itself of the proposed exemption. Similarly, a firm that immediately reroutes all of its order flow in one type of security, i.e., preferreds, but not others, should get the benefit of the exemption for that security type.

To promote fairness and alleviate the unrealistic logistical burdens described above, an exemption should be extended to all reporting firms based on the number of manual orders they handle as a percentage of total volume and this should be viewed separately for each type of security. The marginal value to surveillance and enforcement of the exempt information will be miniscule compared to the savings in cost, efficiency and competition that could be had from such an exemption. We would welcome the opportunity to work with the SEC and NASDR in crafting appropriate exemptions.

⁵ Many firms use Nasdaq's ACES facility to route manually received orders for execution. Nasdaq's ACES system does not currently provide firms the ability to input an order identifier. Thus, firms that enter orders directly into Nasdaq's ACES facility cannot comply with the rules as currently proposed.

Timing

SIA believes that the December 15 date is far too aggressive for implementation of Phase III. Because of the uncertainty surrounding the details of the Phase III rules, most firms have refrained from further programming efforts. In addition, firms have established IT priorities – i.e., the expected full rollout of decimals in December - which cannot now be changed, in addition to year-end system freezes. No programming decisions or resolution of interface problems with vendors and ECN's can begin until final technical specifications are issued by NASDR. Therefore, SIA recommends that the implementation date be tied to the date of publication of final specifications. The firms agree that 90 days from the time the specifications are made public will give the firms the requisite amount of time to prepare adequately for Phase III.

If you have any questions, or would like to discuss this further with the Ad Hoc Committee, please contact Scott Kursman, Assistant General Counsel, at 212-618-0508.

Sincerely,

Stuart J. Kaswell
Senior Vice President & General Counsel

CC: The Honorable Arthur Levitt, Jr. Chairman
The Honorable Isaac C. Hunt, Jr. Commissioner
The Honorable Paul A. Carey, Commissioner
The Honorable Laura S. Unger, Commissioner
Annette L. Nazareth, Director, Division of Market Regulation, SEC
Richard H. Walker, Director, Division of Enforcement, SEC
Robert L.D. Colby, Deputy Director, Division of Market Regulation, SEC
Stephen M. Cutler, Deputy Director, Division of Enforcement, SEC
Belinda Blaine, Associate Director, Division of Market Regulation
Elizabeth K. King, Associate Director, Division of Market Regulation
Self-Regulation and Supervisory Practices Committee
OATS Ad Hoc Committee