April 6, 2001

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: Proposed Rule Changes of Self-Regulatory Organizations (Release No. 34-43860; File No. S7-03-01)

Dear Mr. Katz:

The Federal Regulation Committee, Self-Regulation and Supervisory Practices Committee, Trading Committee and Compliance & Legal Division (collectively, the "Committees") of the Securities Industry Association ("SIA")[1] appreciate the opportunity to comment on the above-referenced rule filing, in which the Securities and Exchange Commission (the "Commission") proposes to adopt Rule 19b-6 of the Securities Exchange Act of 1934 ("Act") in place of existing Rule 19b-4 ("Rule Proposal"). New Rule19b-6 would, *inter alia*: (i) require the Commission to issue a release announcing a proposed self-regulatory organization ("SRO") rule change within 10 business days of filing with the Commission, or such longer time as the SRO consents to in writing; (ii) eliminate the five-day pre-filing and 30-day operational delay requirement for non-controversial rule changes; and (iii) permit almost all trading rules to become effective immediately upon filing with the Commission. The Commission also proposes to create accompanying new Form 19b-6 to reflect the changes made by the Rule Proposal.

The Committees commend the Commission staff on its efforts to streamline the SRO rule-filing procedures, and concur that prompt public notification of all SRO rule filings will promote effective and efficient rulemaking. Accordingly, the Committees support the Commission's issuance of a release announcing SRO rule changes within 10 business days of filing with the Commission.

The Committees also appreciate the need for innovation and regulatory flexibility in this highly competitive and rapidly changing securities market. The Committees, however, strongly oppose the proposed accelerated SRO

rulemaking procedures because, contrary to the Commission's stated objectives, we do not believe they will enhance

investor protection and provide greater regulatory certainty. Notwithstanding inherent delays, existing notice and comment procedures are a vital component of the regulatory process. They enable interested parties to provide valuable information about actual market practices and potential consequences early enough in the process to avoid promulgation of ineffective or overly burdensome rules and regulations. By permitting SRO rules, and particularly those relating to trading practices, to become effective immediately upon filing with the Commission without benefit of prior public review and comment, the Rule Proposal increases the likelihood of inefficient or otherwise potentially deficient SRO rulemaking.

Our primary objection to the Rule Proposal is its sweeping inclusion of almost all SRO "trading rules" within the scope of rulemaking that may qualify for expedited treatment -- rules that in the past have prompted lengthy debates, as well as subsequent clarifications, interpretive guidance and repeated delays. We are especially concerned by the elimination of a 30-day operational delay for these types of rules. As detailed below, even seemingly minor trading rules may necessitate changes in policies, procedures and technology for full compliance. The logistics and resources involved in interpreting, effecting and testing such changes for member firms can be substantial and often require significant lead-time. Rule 19b-6 does not provide firms with adequate time in advance of effectiveness to prioritize obligations and take the necessary preparatory steps to ensure compliance. Rather, it forces firms -- for fear of regulatory liability -- to hastily commit time, effort and resources to conform both systems and procedures to a new rule without the appropriate analysis and resolution of actual and corollary issues. Such rushed compliance only increases the likelihood of mistakes, confusion, additional cost, systems disruptions and market risk, all of which ultimately impact markets adversely and detract from customer protection.

Moreover, by relying exclusively upon post-effective notice and comment procedures to raise regulatory deficiencies, the Rule Proposal invites potentially inferior SRO rulemaking that must later be abrogated by the Commission upon consideration of public comment, thus requiring more active and costly intervention by the Commission and staff. Meanwhile, member firms, having already devoted resources and incurred related costs in making the necessary adjustments, will face additional burdens and expense to unwind the initial changes.

In light of the foregoing, we urge the Commission to reconsider the current Rule Proposal. Instead, should the Commission nevertheless conclude that accelerated approval of SRO rule filings is necessary, we respectfully request the

Commission seriously consider the alternatives presented in Part IV of this letter, which we believe more sensibly balance competitive incentives with the appropriate levels of investor protection, regulatory certainty and fairness.

I. Prior Notice and Comment Fosters Effective and Efficient Rulemaking

Among the most troubling aspects of the Rule Proposal is its deferral of public notice and comment until after the SRO rule is in effect and operative. In the Rule Proposal, the Commission seeks to permit certain categories of SRO rules that "effect minor changes," as well as the vast majority of trading rules, to become effective immediately upon filing with the Commission without benefit of prior public review and comment. The stated objective of such a process is to enable SROs to introduce changes to their markets more swiftly, and thereby better compete with Alternative Trading Systems ("ATSs") that are not subject to the same regulatory filing requirements under the Act.

The Committees are aware of the existing business tensions between entities that are regulated as broker-dealers and those that are not. Notwithstanding such tensions, we cannot ignore the different roles ATSs and SROs serve and the extent to which member firms may be adversely affected by the imposition of new regulatory obligations that were not properly vetted prior to implementation. As fittingly observed by the Commission, SROs are "quasi-public agencies" that "exercise certain quasi-governmental powers over members through their ability to impose disciplinary sanctions, deny membership, and require members to cease doing business entirely." Indeed, SROs are legally bound to enforce their rules against their members, subject to Commission sanctions for failure to do so. By contrast, ATSs are private entities that neither establish conduct rules, nor have the ability to discipline subscribers other than by exclusion of trading. Thus, notwithstanding the Commission's attempt to level the regulatory playing field, we believe that the proposed procedures are ripe for abuse and indeed inconsistent with elemental notions of fairness and due process.

The public notice and comment procedures under Section 19(b)(1) of the Act serve several fundamental policy objectives. Chief among them is regulatory efficiency and transparency.[2] Specifically, such procedures ensure that affected parties are afforded a reasonable opportunity to review and question SRO action prior to implementation. Likewise, the process enables parties of differing perspectives to provide additional information and alternative solutions not always contemplated or addressed in a rule proposal. Consequently, there is less necessity for SROs to repeatedly correct, clarify or otherwise substantiate their rule proposals. In the end, this produces more precise, well-tempered, resource-efficient regulation that ultimately serves investor, industry and regulator alike.

Under the Rule Proposal, market participants will not have an opportunity to view the rule change in its entirety and raise concerns until the rule's publication in the *Federal Register* after it becomes effective. Such a *post-facto* regime hardly provides meaningful comment since firms would have already responded to the rule change by making the requisite systems and procedural adjustments to conform to their new regulatory

obligation. Meanwhile, the public is left with potentially flawed regulation that must be rescinded subsequently upon scrutiny and abrogation by the Commission.

II. Trading Rules are Especially Unsuitable For Immediate Effectiveness

Public notice and comment is particularly valuable within the realm of trading rules, where industry familiarity and experience are often crucial to a thorough assessment of a rule's practical implications. Because trading technology and broker-dealer automated systems have become increasingly sophisticated, ostensibly minor changes to trading practices often have far-reaching ramifications beyond those initially envisioned by an SRO rule. Input and analysis from all interested parties, such as compliance, trading, systems and third party technology providers, uncovers possible problems or potential consequences that may have been overlooked by an SRO rule proposal. It also allows the industry to offer alternate solutions in light of actual business practices and existing systems. By allowing for such productive dialogue prior to rule effectiveness, the current regulatory structure avoids undue effort, expense and repeated regulatory clarifications.

Consider, for example, the NASD's riskless principal trade reporting rules. At first blush, these rule changes appeared fairly straightforward. Yet, as everyone soon learned, compliance with the rules had far-reaching systems implications that were neither contemplated nor addressed in the adopting releases. Consequently, implementation was postponed several times while the NASD repeatedly clarified various aspects of the rule and incorporated suggestions of the industry.

Another example is the NASD's most recent marketable limit order interpretation, which became immediately effective because it was an "interpretation" rather than a rule change. By treating marketable limit orders as market orders rather than limit orders, the NASD prevented such orders from continuing to "jump" from the back of the market order queue to the front of the limit order queue. While the end result was probably correct from a policy standpoint, the problem was that the firms' systems were programmed precisely the opposite way in compliance with previous interpretations. Consequently, firms were "out of compliance" as soon as this new interpretation was

announced, which could have been avoided had member firms been given the opportunity to raise these issues prior to implementation.

Therefore, while the Committees recognize that the current notice and comment procedures may prolong enactment of SRO rulemaking, we firmly believe that, in the long run, they promote transparent, efficient and effective regulation.

We also believe that the Commission cannot rely solely upon the SROs' internal vetting processes to properly capture the divergent perspectives and concerns of affected parties. For instance, internal SRO procedures may involve review and majority approval of rule proposals by special function committees. While these committees typically include industry members, there is no assurance that a handful of industry representatives will provide the "big picture" view obtainable through broader notice and comment procedures. In fact, such committees may not include industry members from the relevant business unit or with the requisite expertise to conduct a proper analysis of the rule's ramifications. Thus, absent procedures that canvass all interested parties, there is great risk that SROs will not fully appreciate the implications of a new trading rule, including whether such rule will make "fundamental structural changes to the market" or "significantly affect the protection of investors."

We appreciate the Commission's concern that undue delays in implementing changes to capital markets may stifle innovation. Nevertheless, the speed of rule changes must be predicated upon the reasonable exposure of rules by SROs to affected parties before they become effective, particularly if members will be subject to sanctions for non-compliance. Although the option is available to them, SROs often do not provide notice to members or a comment period with respect to such proposed rule changes. Consequently, firms first learn about rule changes when the Commission notices them for public comment. Given such practices, it is unreasonable for the Commission to further restrict the availability of meaningful review and comment for those most impacted by the adoption of SRO rules.

III. Rule 19b-6 Does Not Provide Adequate Time For Normal Preparatory Efforts

Equally problematic is the ability of SROs to mandate and enforce instantaneous compliance with Rule 19b-6 changes without regard for normal preparatory efforts. As proposed, Rule 19b-6 eliminates the 30-day operational delay for "non-controversial" rule filings, and permits those rules, along with the vast majority of SRO trading rules, to become effective and operative immediately upon filing with the Commission.[3] The practical effect is that, irrespective of operational burdens or attendant costs, member firms will be obligated to implement the requisite rule change upon announcement by the Commission, or face potential disciplinary action for failure to do so. Experience

shows, however, that despite best efforts, prompt implementation of trading rule modifications simply may not be feasible given the inherently technical characteristics of such rules.

As with any rule change, those relating to trading practices will typically require some form of change to broker-dealer systems, policies and procedures. Due to the complexity and interdependency of systems, however, trading rule modifications may necessitate a host of technology adjustments that extend well beyond trading utilities. These could include linking information not previously connected, or capturing specific data from platforms not already integrated within the mainframe systems. It could also include modifying trade reporting protocols, surveillance systems and supervisory procedures.

Firms, therefore, must be afforded adequate time to prioritize, plan for and implement the necessary changes. They also must be able to analyze, expose and resolve any inevitable systems "glitches" in advance of implementation in order to avoid unnecessary regulatory liability. There is also testing and training of personnel to be considered. Some firms also rely on third-party providers for trading functionalities who have their own agenda or timetables. Add to the equation increased demands on information technology staff, as well as other ongoing systems challenges, regulatory obligations and business initiatives with which members must contend on a daily basis, and it becomes increasingly evident that SRO trading rules are particularly unsuitable for the expedited treatment proposed under Rule 19b-6.

At best, there will be rushed compliance, which only increases the likelihood for mistakes, confusion, and operational disruption -- all requiring additional time, work and money to resolve. At worst, the realities of implementation will prevent timely compliance, thus exposing firms to unnecessary regulatory liability.[4] Thus, notwithstanding increased competitive pressures from ATSs, reducing regulatory filing requirements for SROs, as articulated in the Rule Proposal, will not promote innovation, enhance investor services or create regulatory certainty as envisioned by the Commission. Accordingly, we request the Commission to reconsider the current proposal. Should the Commission, nonetheless, determine that investors are better served by streamlining the regulatory rule filing requirements for SROs as proposed, we strongly urge the Commission to give serious consideration to the alternatives we offer below.

IV. SIA Alternatives

Before subjecting firms to new regulatory obligations that were not noticed for public comment in advance of effectiveness, the Commission should ensure that adequate safeguards are maintained and practical impacts carefully deliberated. Specifically, a better alternative is one that expressly limits the scope of rules that may qualify for expedited treatment to those rules that can be

implemented readily with minimal impact on member firms' technical and supervisory systems. Under the Rule Proposal, the only SRO rules ineligible for immediate effectiveness are those that "make fundamental structural changes to that SRO's market and that significantly affect investors or impose a significant burden on competition." SROs, therefore, may create new substantive obligations for firms without any required analysis of whether compliance can be accomplished readily. Nor are SROs compelled to examine potential administrative, operational or economic burdens to the industry prior to filing with the Commission. To promote efficiency and avoid overly burdensome regulation, the Commission should specifically require SROs to undertake the foregoing analysis and certify to such minimal impact as part of their Form 19b-6 filing as a precondition for immediate effectiveness. Such an approach, we believe is entirely consistent with the Commission's objectives, as well as the mandates of Section 3(f) of the Act.[5]

Alternatively, the Commission should suspend operation of a new or amended trading rule for 30 days in order to permit the marketplace to identify possible unintended consequences and implementation complications in time to take corrective action. It will also permit the Commission to abrogate the rule and activate the normal notice and comment procedures without risk of systems disruptions.

Finally, the Commission should include a mechanism for the consideration of applications, on an equally streamlined and expedited basis, for emergency stays of rules in the event of exigent or unanticipated occurrences relating to rule implementation.

V. Conclusion

The Committees appreciate the opportunity to provide comments on the Rule Proposal. While the Committees commend the Commission's efforts to improve SRO rule filing procedures, Rule 19b-6 is fraught with difficulties and does not adequately take into account the practical implications of the proposed accelerated rulemaking. The Committees believe that the regulator's need for flexibility must be balanced against the need for regulatory transparency, consistency and fairness. Accordingly, we strongly urge the Commission to reconsider the Rule Proposal and at a minimum seriously consider the alternatives presented by the Committees.

If you have any questions or would like to discuss our comments further, you can contact Amal Aly, Staff Advisor to the Self-Regulation and Supervisory Practices Committee at (212) 618-0568.

Sincerely,

Christopher R. Franke

Chairman
Self-Regulation and Supervisory Practices Committee

Joseph Polizzotto
Chairman
Federal Regulation Committee

Peter C. Cohan
Chairman
Trading Committee

Michael H. Stone
President
Compliance and Legal Division

cc : Honorable Laura S. Unger, Acting Chairman
Annette Nazareth, Esq., Director, Division of Market Regulation
Robert L. D. Colby, Esq., Deputy Director, Division of Market Regulation
Belinda Blaine, Esq., Associate Director, Division of Market Regulation
Jack Drogin, Esq., Assistant Director, Division of Market Regulation
Joseph P. Corcoran, Division of Market Regulation

---

[1] The Securities Industry Association brings together the shared interests of more than 680 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] Notably, during the past year, SIA has undertaken a project to improve and enhance global regulatory transparency. The lynch-pin of this effort has been the development of a paper entitled, *Promoting Fair and Transparent Regulation*, outlining the fundamental principles upon which transparent markets are built. Among the principles noted under rulemaking and interpretation, are that: (i) regulators should utilize open and public processes for consultation with the public on proposals for new regulations and changes to existing regulations; and (ii) market participants should be given a reasonable period of time to implement new regulations. We believe these goals are in the best interests of the public and that the proposed changes to Rule 19b-6 contravene the core principles of regulatory transparency.

[3] With respect to the "non-controversial" category, such rule filings qualify for immediate effectiveness provided the rule does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) permit unfair discrimination between customers, issuers, and brokers or dealers. Trading rules, which are governed under a separate provision, similarly become operative immediately upon filing, provided the SRO certifies that it is has established surveillance and enforcement procedures for activity conducted pursuant to the trading rule. The only trading rules ineligible for immediate

effectiveness are those that would make fundamental structural changes to the market, significantly affect the protection of investors or impose a significant burden on competition.

[4] Several SROs, including the NASD, have imposed numerous and significant disciplinary actions against member firms for supervisory deficiencies, in the areas of trade reporting, market-making activities, and order-handling practices. Of particular focus are firm's written supervisory procedures, are routinely scrutinized by regulators during regulatory examinations.

[5] Section 3(f) requires the Commission, whenever engaged in the review of an SRO rule, to consider whether the rule is necessary or appropriate in the public interest and whether it will promote efficiency, competition and capital formation. 15 U.S.C. 78c(f).