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")

[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] 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").

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. <u>Equity Market Structure: Governing Principles and Current Performance</u>

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

[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/EquityTradinginthe2lstCentury.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. <u>Current Market Structure Issues</u>

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. <u>Co-Location, Individual Data Feeds, and HFT Trading Strategies</u>

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

[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

[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

[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

[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. <u>Suggested Regulatory Initiatives</u>

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

[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

[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
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